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Chairman
PDC N°74

Paris, October 19th, 2016

Mr Andrea Enria
Chairman of the European Banking Authority
One Canada Square (Floor 46)
Canary Wharf
London E14 5AA| UK

Re: Consultative Paper from European Banking Authority on "Draft Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses"

Dear Mr Enria,

I am submitting the comments of the Board of 'Autorité des Normes Comptables' (ANC) as discussed during its meeting on October 14th, 2016, to the above-mentioned Consultative Paper (CP) from the European Banking Authority (EBA) with regard to the guidelines on accounting for expected credit losses (ECL). ANC decided not to respond to the consultation regarding guidelines on credit institutions' credit risk management as these are outside its scope.

Question 1: Is the scope of application of the guidelines appropriate and sufficiently clear?

ANC observes that the scope of the BCBS' guidance applies to "internationally active banks" whereas the CP (§ 7 p.12) of EBA regarding accounting for expected credit losses (ECL) to "credit institutions" applying IFRS. Accordingly, ANC understands that the scope of application of EBA guidelines may be slightly broader than the BCBS one.

ANC understands that EBA as well as BCBS guidelines only deal with "lending exposures" (§ 7 p.12). It does not cover the overall scope of IFRS 9 related to the ECL accounting model, and especially excludes exposures on financial commitments and debt securities accounted at cost or fair value through OCI. ANC believes that such exclusion of the scope can lead to a non-homogenous quality of the risk management practices promoted by EBA, and more specifically of the accounting model of impairment.

Question 2: Is the date of application of the guidelines of 1 January 2018 appropriate?

Aligning the date of application of the guidelines to the first application date of IFRS 9 is appropriate.

Question 3: Please provide any comments you may have on the appropriateness of the proposed proportionality approach.

The guidelines address the "proportionality approach" in the two following paragraphs:

- Paragraph 4.1.1, which specifies in § 17. *Credit institutions should comply with these guidelines in a manner that is appropriate to their size, internal organization and the nature, scope and complexity of their activities and, more generally, all other relevant facts and circumstances of the credit institution and the group (if any) to which it belongs.*
- Paragraph 4.3.3, related to the use of practical expedients, which intends to limit the application to "*both smaller and less complex credit institution* " (§ 129)

Both paragraphs help to address proportionality according to the same criteria of size and complexity. However in § 129, practical expedients are restricted to "smaller and less complex credit institutions" whereas § 17 potentially extends the proportionality approach to a broader scope of credit institutions based on a duly supported judgement. Moreover, terms such as "smaller" or "less complex" do not relate to a precise point of reference. More detailed definitions, comments and examples could enhance the consistency of application of the guidelines.

In addition, within an internationally active bank itself, the proportionality approach may be applied to some of its activities and exposures, according to § 17. However, § 129 restricts the use of practical expedients at credit institution's level, and therefore excludes its use at a lower level, such as its activities. ANC therefore suggests to replace in § 129, "credit institution" by "activities".

ANC notices that EBA guidelines do not provide guidance on the application of the principles of proportionality and practical expedients within internationally active banks. In this regard, ANC would suggest for instance that, within a group, if an activity is performed by several entities with similar risk exposures, the group should apply a sound ECL methodology to that activity, irrespective of each entity's size. Conversely, if one entity is exposed to specific risks departing from the exposure of other entities conducting the same activity, it is justified to assess whether a specific methodology (or even practical expedients) should apply to that entity.

As a conclusion, ANC is in favour of the use of professional judgment duly supported by comparable criteria as described in § 17. On the other hand, ANC considers that § 129, limiting the use of practical expedients to criteria of both size and complexity may be too restrictive and would ignore the costs/benefits approach promoted in § 70.

Question 4: Do you agree with the draft guidelines which introduce the relevant BCBS Guidance in the EU regulatory framework? Are there additional issues for which the EBA Guidelines should be amended in the context of finalising the guidelines?

ANC restricts its comments to potential accounting issues and therefore does not express any opinion on regulatory requirements.

ANC identifies two issues that could be amended in the context of finalising the guidelines:

a) The draft guidelines, in § 41, consider the specific definition of forbearance established in Commission Implementing Regulation (EU) 2015/227 amending Part 2 of Annex V (§ 176-178), to assess the decrease in the credit risk on exposures of loans on a timely manner (the probation period issue).

   ANC considers that applying a probation period looks consistent with judgments on transfers between credit risk categories.

   ANC noticed that § 176 (b) of the regulation on forbearance included in the Commission Implementing Regulation, refers to "*a minimum two year probation period*".

   § 176 The classification as forborne shall be discontinued when all of the following conditions are met: [...] (b) a minimum two year probation period has passed from the date the forborne exposure was considered to be performing;

According to the characteristics of the credit risk of the borrowers, and the judgment that should lead to the determination of consistent probation periods, ANC recommends EBA to explicitly mention the exclusion in § 41, this "*minimum two year*" threshold.

More generally, ANC mainly promotes internal credit risk assessments, as prevailing on the determination of probation periods, and recommends § 41 to be modified in this regard.

b) ANC notes that the reference to the professional judgment in § 60 of the BCBS' guidance has not been retained in § 65 of the CP of the EBA:

§ 60 *"As the development and use of ECL assessment and measurement models involves extensive judgment, effective model validation policies and procedures are crucial".*

ANC supports the inclusion of professional judgment in developing impairment models, and recommends EBA to express its position on this topic, and/or maintain in its § 65, the BCBS' guidance (§ 60).

Question 5: Do you agree with the impact assessment and its conclusions, having regard to the baseline scenario used for this impact assessment? Please provide any additional information regarding the costs and benefits from the application of these guidelines.

ANC shares EBA's concerns about the comparability issue, and therefore supports a homogeneous implementation of ECL accounting model in all European countries. As a consequence, ANC supports EBA's initiative to promote BCBS guidance in Europe and to propose common criteria for developing the proportionality approach (see ANC's answer to the response Q3).

However, the application of these guidelines and their monitoring are key, and the subsidiarity principle should in our view apply, i.e. country by country application should be monitored by the local authorities, having regard to market specificities, each relevant authority operating within its remit.

For example, in France, the proper application of EBA's guidelines dealing with the banking regulation (especially the credit risk management issue) is under the responsibility of the supervisory competent authorities (Autorité de Contrôle Prudentiel et de Résolution and/or the ECB for significant banks), and those dealing with the accounting for ECL is under the responsibility of ANC (especially the §4.3 "*Guidelines specific to credit institutions applying IFRS 9*").

As a consequence, ANC believes that a direct request to banks is not an appropriate channel of implementation.

With regard to the Conclusion (§E, page 63), ANC concurs with the positive opinion on benefits expected from IFRS 9 on the European financial stability. With regards to EBA's assertions stating that its guidelines would insure a "*level playing field at the international level*", ANC notices that:

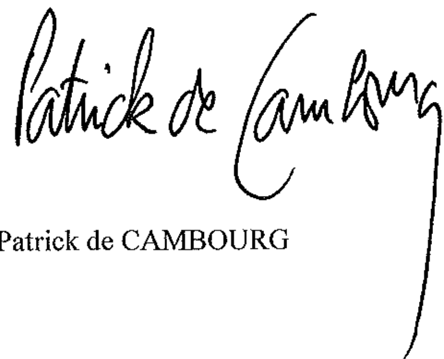
- Convergence with US GAAP has not been achieved, especially on the accounting model of impairment on financial instruments;
- At this stage, it appears difficult to anticipate a comparable level of requirements from banking regulators outside Europe, regarding the new accounting impairment models.

Question 6: Please provide any additional comments on the draft guidelines

In a more general point of view, ANC confirms its opinion on the ECL accounting model, as already expressed to the BCBS in its letter dated 10th May 2015 (see Appendix).

If you have any questions concerning our position, we would be pleased to discuss them.

Your sincerely,



Patrick de CAMBOURG

Appendix

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Le Président

PDC/
N° 441

Paris, le 10/05/2015

Mr René VAN WYK
Chairman Accounting Experts Group
Basel Committee on Banking Supervision
Centralbannplatz 2
4051 Basel
Switzerland

Re: Consultative Document from Basel Committee on Banking Supervision "Guidance on accounting for expected credit losses", important issue raised by the Autorité des Normes Comptables

Dear Mr Van Wyk,

I am writing to submit an important issue raised by the Board of the Autorité des Normes Comptables (ANC) recently, on the above-mentioned Consultative Document from the Basel Committee on Banking Supervision (BCBS).

This issue is related to paragraph A15 of the guidance, which states that "*any post-origination increase in credit risk is unlikely to be fully compensated by the interest rate charged*", and to footnote 33 of paragraph A27(a), which introduces a "*rebuttable presumption that any increase in the credit spread that would be charged for a particular loan is due to an increase in the bank's assessment of the credit risk of that exposure.*" (see details in attached Appendix).

The ANC, as expressed in its letter dated 8th July 2013, is generally supportive of the IASB's initiative to establish an expected losses model of impairment with IFRS9 phase II, replacing IAS39 incurred losses model. However, the ANC is of the opinion that the expected credit losses model of IFRS9 introduces elements of over-impairment, by segregating on an on-going basis (according to appropriate triggering events and earlier than under IAS39) low (stable) credit risk financial instruments and deteriorated credit risk financial instruments and by requiring:

- a life time expected credit losses reserve on deteriorated credit risk financial instruments,
- a 12-month expected credit losses reserves on low (stable) credit risk financial instruments.

From a conceptual standpoint, under the amortised cost model, matching revenues and costs is key. As a consequence, for basic lending activities, the cost of risk (risk premium), introduced at pricing level via the interest rate, is not to be considered as an element of profit when it is received by the lender. It is to be deferred in order to cover the losses when they occur since the pattern for the perception of the risk premium and the pattern for the effective occurrence of losses differ by construction. Conceptually, this risk premium model compensates at all reporting dates the mismatch between the above two patterns. If the cost of risk introduced at pricing level is not sufficient to cover expected losses, an additional reserve is needed. Such a model organises a proper matching between the risk

premium (initial or adjusted) and the effective losses. It allows the lender to have a net of risk profit pattern over the full life of the financial instruments.

There are circumstances where the 12-month expected credit losses model is more prudent than the above described risk premium model. For instance, the model can be deemed to overstate losses at initial recognition as there is no economic loss if credit risk is reflected in the initial price of the instrument. This is generally the case when the credit losses occur evenly during the life of the financial instruments or occur at an early stage in the life of the financial instruments. There are also exceptional circumstances where the 12-month expected credit losses model may be less prudent than the risk premium model. It is the case in particular when losses occur at a late stage of the life of the financial instruments, unless the 12-month standard period is extended to a proper horizon under the option offered by IFRS9 in paragraph B 5.5.13.

The lack of a conceptual rationale for the 12-month expected credit losses model is to a certain extent mitigated by the following practical considerations:

- Better conceptual approaches, in particular the risk premium model, have been explored but abandoned as they were deemed not to be operational due to alleged complexity. In contrast, the 12-month expected credit loss is designed to make the requirements in IFRS 9 operational. The inputs used for the calculation of 12-month probabilities of default are already tracked by many financial institutions for prudential regulatory requirements; and
- Even though the recognition of 12-month expected credit losses may overstate losses at initial recognition and over the life of the financial instruments in most cases, it addresses the criticism that accounting models do not provide for timely recognition of impairment losses. From this perspective, 12-month expected credit losses can be viewed as a compromise between the non-recognition of losses at the instrument's inception, which might be conceptually sound, and application of prudence to provide timely recognition of impairment losses.

Compared to the above conceptual approach for financial instruments measured at amortised cost, the ANC assesses that IFRS9 introduces an element of additional prudence in most cases. The magnitude of this element of additional prudence depends on the pattern of loss occurrence over the life of the corresponding financial instruments.

Therefore, in a general context of over-impairment, as explained above, the ANC considers that an increase in credit spread constitutes one element among others (such as market appetite, liquidity risk, competition between operators…), which should not automatically lead to an increase in expected losses reserves, this view being consistent with IFRS9 B5.5.17(a). The ANC does not accordingly support the introduction of a "rebuttable presumption" on credit spread and specially the use of tightened links between the pricing and the analysis of an increase in credit risk. This view is consistent with IFRS9 BC 5.164 (see Appendix hereafter).

As a consequence, the integration of paragraphs A15 and A27(a) as elements of an implementation guidance of the expected losses impairment model of IFRS9 is not justified.

If you have any questions concerning our position, we would be pleased to discuss them.

Your sincerely,

Patrick de CAMBOURG

Appendix

Guidance BCBS	IFRS 9
§A15. The Committee believes that the rationale for this approach is that ECL anticipated upon initial recognition will be taken into account in the pricing of credit at that time (31). It follows, then, that any post-origination increase in credit risk is unlikely to be fully compensated by the interest rate charged, and, as a consequence, a bank must carefully consider whether there has been a significant increase in credit risk. If so, the lending exposure would be subject to LEL measurement. Footnote (31) See, for example, IASB Snapshot on IFRS 9, page 20, which notes that "*[w]hen credit is first extended the initial creditworthiness of the borrower and initial expectations of credit losses are taken into account in determining pricing and other terms and conditions*" *and that* "[a] true economic loss arises when expected credit losses exceed initial expectations (i.e. when the lender is not receiving compensation for the level of credit risk to which it is now exposed)	BC5.164 The IASB noted a number of disadvantages to this approach. In a similar way to an approach based on the absolute level of credit risk or a change in the credit risk management objective, this approach would not require the change in credit risk since initial recognition to be assessed. It would thus be inconsistent with the IASB's objective of reflecting increases in credit risk and linking that to pricing. The objective of setting credit underwriting limits also follows a different objective compared to that of financial reporting, which could result in a misstatement of expected credit losses. For example, changes in underwriting policies may occur for business reasons, such as wishing to increase lending, resulting in changes to the recognition of expected credit losses on existing financial instruments irrespective of changes in credit risk.
§A27 While it is neither possible nor desirable for universally applicable criteria to be developed, the Committee emphasises 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 exposure would be higher than it was when the loan was actually originated as a result of the change in credit risk since inception; (33) Footnote (33) Where management is unable to distinguish this element of pricing from others, such as the general price of credit risk or changes in gross margins charged due to other factors such as changing capital requirements, the Committee expects banks to adopt a rebuttable presumption that any increase in the credit spread that would be charged for a particular loan is due to an increase in the bank's assessment of the credit risk of that exposure.	B5.5.17 The following non-exhaustive list of information may be relevant in assessing changes in credit risk: (a) significant changes in internal price indicators of credit risk as a result of a change in credit risk since inception, including, but not limited to, the credit spread that would result if a particular financial instrument or similar financial instrument with the same terms and the same counterparty were newly originated or issued at the reporting date.