15 April 2010

Our ref: ICAEW Rep 38/10

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Dear Sir or Madam

Commission services staff working document, Possible further changes to the Capital Requirements Directive (February 2010)

The ICAEW welcomes the opportunity to comment on the staff working document*, Possible further changes to the Capital Requirements Directive* published by the European Commission in February 2010.

The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide. The ICAEW is listed in the European Commission's Interest Representative Register (ID number: 7719382720-34).

We are particularly interested in section V of your paper, 'Countercyclical measures'. We do not have the resources to perform a comparative assessment of the three different methods invited at question 38, but would like to respond to question 39, where 'Views are sought on the suggested IRB based approach with respect to the through-the-cycle provisioning for expected losses as outlined above'.

First, we would like to challenge the statement that the Spanish model has 'proven effective'. The text at paragraph 131 does not make clear exactly what the Spanish model has proven effective at. To our knowledge, even ardent proponents of a Spanish model of provisioning would not claim that it was the key factor in enabling Spanish banks to weather the financial crisis better than their counterparts. Rather, it was only one element in the regulatory and reporting framework; other differences included the fact that the Spanish banks had a lower proportion of investment banking, in particular structured credit activities, than in other countries. Indeed, whether it made a positive difference at all has not been conclusively established: the relationship between the Spanish approach to provisions and the financial crisis has yet to be properly analysed, as much of the research on which current policy proposals are being developed does not go beyond 2008. In our view, the impact of inadequate provisions in the financial statements as a contributing factor to the financial crisis is being overstated, and expectations as to the positive effects that changing approaches to provisions will have are correspondingly misplaced.

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We note that the International Accounting Standards Board is currently working on the impairment of financial assets, and we will be commenting on their exposure draft in due course.

We suspect that if policy is developed along the lines articulated in the staff paper, the amount of capital required by banks will increase, and that in practice it will be hard to release provisions during a downturn.

We attach our response to the Basel Committee's consultation, 'Strengthening the resilience of the banking sector' (December 2009), as this sets out our views on issues which are also in your working document. Finally, the views we expressed to you in our response to last year's staff working document, 'Possible further changes to the Capital Requirements Directive' continue to represent our position: we have not seen compelling evidence that makes us think through-the-cycle provisioning is going to improve the quality of financial reporting by banks so have not revised our views.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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