ICAEW REPRESENTATION 06/17

Regulatory treatment of accounting provisions - discussion document

ICAEW welcomes the opportunity to comment on the *Regulatory treatment of accounting provisions - discussion document* published by Basel Committee on Banking Supervision on 11 October 2016, a copy of which is available from this link.

This response of 13 January 2017 has been prepared on behalf of ICAEW by the Financial Services Faculty. As a leading centre for thought leadership on financial services, the Faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The Faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA UK

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City
icaew.com

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MAJOR POINTS

1. ICAEW broadly supports the Basel Committee on Banking Supervision (hereafter referred to as "Basel" or "the Committee")'s aims of reviewing the regulatory treatment of accounting provisions in light of the introduction of new accounting standards (IFRS9 for accounting periods beginning on or after the 1 January 2018 and CECL for accounting periods beginning on or after 1 January 2020 for SEC filers and 1 January 2021 for all other entities).

2. ICAEW supports the development and application of robust prudential regulatory capital standards to banks and other financial institutions which aligns with its support of well-functioning capital markets and financial stability.

3. Given the complexity of both the expected loss accounting standards[1] and the prudential regulatory capital regime we support the Committee's initiative to examine the interaction between the two regimes to ensure that there are no unexpected or undesired outcomes arising from the adoption of the new accounting standards. The expected loss accounting standards could result in accounting that is volatile and pro-cyclical, particularly under stressed conditions and this means that it is necessary that the interaction with the regulatory requirements is well understood.

4. A range of stakeholders (regulators, analysts, investors, wider capital markets, users of financial statements, customers) need to have confidence in banks and other financial institutions and we welcome the opportunity to feed into the Committee's examination of the right way to align the accounting and regulatory regimes and also the decision as to whether there should be any transitional approach.

5. Whilst we support the Basel Committee examining this issue we believe that the timing of this exercise has not been very well scheduled. It is not aligned with the overall re-calibration exercise going on for both the standardised approach to credit risk and the internal ratings based (IRB) approach to credit risk through the analysis of variability of risk weightings. In addition, most organisations remain in the implementation phase of their IFRS 9 projects and so do not yet have final IFRS 9 impact numbers with which to support accurate regulatory Quantitative Impact Studies (QIS). The work on the US standard is even less progressed.

6. ICAEW supports proposals which encourage a level playing field amongst organisations both across jurisdictions and within an individual jurisdiction. It also supports the goal of comparability across and within jurisdictions and in its proposals the Committee should aim to ensure consistency and comparability wherever possible.

7. At a time when the variability of regulatory capital calculations is being examined more broadly through the Committee's other work, ICAEW would also make reference to its recent discussion paper[2] on assurance frameworks for Risk Weighted Assets (RWA). Expected loss accounting standards, coupled with the global variability in interpretation of the definitions of general and specific provisions, is likely to generate additional variability in RWA outcomes and further drive the need for RWA assurance.

8. ICAEW's aim in this response is to provide overall thematic observations on matters of principle and specific comments on each of the two papers (consultation paper and discussion paper) where relevant.

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[1] Throughout this response we refer to expected loss accounting standards and mean both the IASB's IFRS9 requirements and the FASB's CECL requirements.
[2] ICAEW discussion paper on RWA assurance frameworks https://www.icaew.com/en/technical/financial-services/inspiring-confidence-in-financial-services/banking-regulatory-ratios

Comments on the Discussion Paper (DP)

9. In response to the DP overall we support a principle of consistency of treatment between Standardised banks and IRB banks – this will become even more important if the Basel Committee decides to introduce floors for model approaches based on the standardised approach at the forthcoming Governors and Heads of State (GHOS) meeting.

In terms of certain of the specific comments raised by the Committee we make the following observations:

10. Section 3.1 – If the Basel Committee leaves it to national competent authorities (NCAs) to determine the definition of GP/SP then this would lead to continuing inconsistency of application.

11. Section 3.2 – Given the ongoing ambiguity about the derivation of some elements of the current prudential capital framework which the introduction of expected loss accounting standards expose, the Basel Committee should clarify the following key elements of the existing framework:

    a) Were the risk weights (RW) for the Standardised approach originally calibrated to cover unexpected loss (UL) only or do they already capture some EL?

    b) To what extent are we comparing apples and pears when we try to incorporate accounting expected losses into the IRB approach and do we therefore have an overlap with a capital requirement (RWA) for unexpected loss as well as a deduction from capital resources for the accounting expected loss?

12. Section 3.4 – ICAEW does not believe that the Basel Committee should define the accounting treatment for financial statements. However, the Basel Committee could and should establish rules for prudential regulatory purposes and should encourage/mandate consistency to drive comparison between jurisdictions and between firms within jurisdiction to maintain trust in the regulatory capital calculations.

13. Section 3.5 – ICAEW does not provide judgment on whether one should begin with the accounting expected loss.

14. Section 3.6 – The Basel Committee should be clear what objectives it is trying to achieve through the review of the alignment with accounting standard changes and it should then examine the situation holistically.

Conclusions

15. In determining the future shape of the Global financial regulatory architecture, the overarching objectives should be to develop robust regulation to maintain confidence in the system, and to ensure it is within a consistent international framework. Our key concerns are to ensure that:

    - The Basel Committee provides clarity over some of the ambiguous underlying principles that cover how the prudential regulatory framework interacts with the expected loss accounting standards;

    - The proposals are considered within the context of the wider prudential regulatory capital changes being consulted on and agreed to avoid any stop-start behaviour;

- That level playing field and consistency issues both within and across jurisdictions are paramount; and

- Appropriate time is provided for transitional rules to support the overall goal of financial stability.