

April 30, 2015

Comments on the Basel Committee on Banking Supervision's Consultative Document "Guidance on Accounting for Expected Credit Losses"

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the consultative document *Guidance on accounting for expected credit losses* issued by the Basel Committee on Banking Supervision (the "BCBS") on February 2, 2015.

We respectfully expect that the following comments will contribute to your further discussion.

<General Comments>

The Consultative Document proposes supervisory requirements on sound credit risk practices associated with the implementation and ongoing application of expected credit loss (ECL) accounting models. We understand the overall objective but consider that there are some areas that should be reviewed from practical reasons. Additionally, discussions currently being made by the BCBS for the review of various regulations should also be considered.

First of all, the main section of this guidance should explicitly specify that the principle of materiality in the accounting framework may be applied to the extent that it facilitates a high-quality implementation of ECL models.

In this guidance, the BCBS expects that a bank will consider all information that is reasonably available and is known to affect the assessment and measurement of credit risk. On the other hand, paragraph 12 "allows less complex banks to adopt approaches commensurate with the size, nature and complexity of their lending exposures". The BCBS is requested to add descriptions that would also allow internationally active banks and those banks more sophisticated in the lending business to take different approaches depending on the materiality of loan assets. For example, the simplification, such as use of practical expedients, should be

permitted for immaterial assets.

Further, even if banks use simplifications for immaterial assets in terms of disclosure, it would not disrupt the users' decision-making.

The second issue relates to the difference in the treatment of wholesale and retail lending. Generally, credit risk management approaches and available information differs between wholesale and retail lending. This guidance therefore should clarify that the treatment for these two does not necessarily need to be the same under ECL accounting practices.

Our comments on specific issues other than the above are described hereinafter.

<Specific Comments: Main Section of the Consultative Document>

1. Principle 3 (Paragraphs 46 and 48)

Paragraph 46 requires that whenever changes in credit risk affect only some exposures within a group, those exposures must be segmented out of the group. And paragraph 48 requires that exposures must be re-segmented whenever relevant new information is received or a bank's expectations of credit risk have changed. However, re-segmentation of exposures is not always the best approach in such cases. Therefore, the guidance should be amended to allow banks to re-segment exposures only when they consider it as appropriate.

<Specific Comments: Appendix>

1. A Significant Increase in Credit Risk (Paragraph A29)

Where banks assign highly-granular credit ratings, a one-notch downgrade would not be indicative of a significant increase in credit risk in many cases. This paragraph however mentions that "it is possible that a significant increase in credit risk could occur before lending exposures experience even a one-notch downgrade," implicitly indicating that banks should assess a one-notch downgrade as a significant increase in credit risk. Given this, the BCBS is requested to amend this description because it could suggest a case that contradicts actual practices.

2. Associated Costs for Investments in New Systems and Processes (Paragraph A49)

We agree that banks should endeavour to develop systems and processes needed to achieve a high-quality, robust and consistent implementation of the approach. However, in order to clarify the objective and to give some consideration to cost effectiveness, it is requested that this paragraph will be amended to require banks to spend appropriate costs needed to achieve a high-quality implementation by taking into account the principles of proportionality, materiality and other factors according to the size and nature of banks' businesses.

Seemingly, paragraph A49 might be construed as a requirement for all banks to bear significant costs. It should therefore be amended to better clarify the objective, i.e. "a high-quality implementation commensurate with the size and nature of their businesses." Further, banks as well as firms in other industries should be allowed to take into account cost effectiveness in accordance with the principle of materiality. For example, for those products with low quantitative materiality, the use of simplified approaches should be permitted relative to core products for banks.

3. "Low Credit Risk" Exemption (Paragraph A58)

It is requested that the third sentence of paragraph A58 (i.e. "When considering the boundary between low-credit-risk and higher-risk exposures...but it may not use one with a higher PD.") be eliminated, or the paragraph be amended to clarify that it is an expectation limited to the case where the external grade rating class is used as a threshold for "low credit risk".

It is understood that this third sentence itself assumes the case where the external grade rating class is used as a threshold for "low credit risk". However, since other parts of this paragraph refer to adjustments between internal and external benchmarks, the sentence may be applied by analogy to the case where the internal rating class is used as a threshold. In such a case, the level of PD for internal ratings regarded by banks as "investment grade" is not always equivalent to that provided by external parties (which may also differ across rating agencies, regions or periods) and thus there would be a case where it may not be appropriate to evaluate "low credit risk" only by comparing PDs. Given that the fourth sentence of paragraph A58

states that banks shall reconsider the appropriateness of the level of PDs where an internal rating class is used for a threshold, it is considered reasonable to eliminate the third sentence, or to amend whole paragraph A58 in order to clarify that it is an expectation limited to the case where an external rating class is used as a threshold.

4. Use of “More-than-30-days-past-due Rebuttable Presumption” (Paragraph A60)

It is our understanding that this paragraph intends to indicate that banks should not rely easily and solely on the more-than-30-days-past-due rebuttable presumption as a practical expedient. But where the more-than-30-days-past-due rebuttable presumption is relied on, it is requested that banks would not be required without reasonable limit to demonstrate that any forward-looking information that is considered potentially relevant does not have a substantive relationship with increases in credit risk. Therefore, the description of this paragraph should be amended accordingly or the second sentence of the paragraph (i.e. “In this perspective, the Committee has a strong expectation that...”) should be eliminated.

This request is intended to prevent undue burden for banks in cases where the more-than-30-days-past-due rebuttable presumption needs to be relied on in practice for some exposures because of the constraints of information availability or from other reasons.

Further, it is next to impracticable to demonstrate that all forward-looking information has no substantive relationship with the level of credit losses, and therefore, such a description may be construed as substantive prohibition of the reliance on past-due information. On the other hand, we fully understand by paragraph A59 the BCBS’s intention to restrict the reliance on past-due information used for the practical expedient. Given this, the BCBS is requested to also consider eliminating the second sentence from this paragraph.