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European Banking Authority
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Our ref CS/288

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Dear Sirs

Consultation Paper — Draft Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses

We appreciate the opportunity to comment on the above Consultation Paper. We have consulted with, and this letter represents the views of, the KPMG network.

We support the European Banking Authority's ('EBA') goals of fostering a high quality implementation of IFRS 9 *Financial Instruments* and the effective and consistent application of regulatory capital requirements in the interests of financial stability. We also support the EBA's objective of implementing the Basel Committee on Banking Supervision ('BCBS') guidance on credit risk and accounting for expected credit losses (the 'BCBS Guidance') into the European system of financial supervision.

However, we believe that the EBA's draft guidelines on credit institutions' credit risk management practices and accounting for expected credit losses ('proposed guidelines') would not achieve the objective of implementing the BCBS Guidance in Europe. This is because the proposed guidelines are addressed to approximately 6,000 credit institutions in the European Union (EU), whilst the BCBS Guidance is aimed primarily at international banks such as those that are systemically important or similarly large or sophisticated. We understand that the EBA generally rolls out guidance and standards issued by the BCBS to all credit institutions in the EU, but we believe that this should not be the case here.

We therefore recommend that the proposed guidelines also be addressed only to systemically important or other large credit institutions in the EU that cover a large majority of total banking assets. For example, the EBA's recent EU-wide stress test covered 123 banking groups that represented more than 70% of total banking assets. We think that it is unclear as to what the specific benefits are of applying the proposed guidelines to all credit institutions in the EU and thus consider that if the overall objective

of introducing the proposed guidelines is to promote financial stability, then this would be achieved by applying them only to systemically important credit institutions.

To the extent that the proposed guidelines were to apply to all credit institutions in the EU, we believe that more extensive guidance would be required around the concept of proportionality and how credit institutions should apply it in practice. For example, the only additional proportionality guidance included in the proposed guidelines relates to mentioning the ability to use practical expedients available under IFRS 9. In particular, there is a lack of clarity and guidance, given the wording in paragraph 131 of the proposed guidelines, as to whether and how smaller credit institutions should apply the concept of undue cost and effort when in possession of a limited information set.

We believe that it would be challenging for the EBA to develop detailed guidance on proportionality that would cater for the differing circumstances of approximately 6,000 credit institutions which have varying degrees of complexity and sophistication and range from the very small to the very large. In these circumstances, a 'one size fits all' approach would not be appropriate. Any such detailed guidance would have to be developed quickly in order for it to be available for credit institutions to use in designing and deploying systems changes in the run up to the effective date of 1 January 2018. In the absence of wider and more detailed guidance on proportionality, the proposed guidelines might impose significant additional costs on smaller credit institutions that exceed the supposed benefits.

Finally, we recommend that the EBA specifically highlights all areas in which the guidelines are intended to be different from the BCBS Guidance, together with relevant explanations. This is so that any differences from the BCBS Guidance can be identified and fully understood.

We include in the Appendix our more detailed comments and answers to the questions in the Consultation Paper.

Please contact Chris Spall +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours faithfully

KPMG IFRG Limited

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Appendix—Detailed comments

This Appendix includes our detailed comments and responses to the specific questions in the Consultation Paper and should be read in conjunction with the comments in the cover letter.

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

As discussed in the cover letter, we disagree with the proposal for all credit institutions in the EU to apply the proposed guidelines. The proposed guidelines have the stated objective of aligning with the BCBS Guidance which was aimed primarily at systemically-important and other large credit institutions.

However, the vast majority of credit institutions that would be subject to the proposed guidelines are not systemically important or large. From the whole population of credit institutions in the EU (5,906 as of 31 December 2014), 156 (or 3%) represent 75% of the total assets of all credit institutions in the EU[1]. The remaining 97% represent only 25% of the total assets of all credit institutions in the EU and generally are not each systemically important.

Hence, we recommend that the proposed guidelines be addressed only to those systemically important or other large credit institutions in the EU that cover a large majority of total banking assets. For example, the EBA's recent EU-wide stress test covered 123 banking groups that represented more than 70% of total banking assets. Applying the proposed guidelines to large credit institutions only would also create a level playing field internationally to the extent that other jurisdictions across the world would also be applying the BCBS Guidance in accordance with its intended scope - e.g. only to large credit institutions.

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

We generally agree with 1 January 2018 as the date of initial application of the proposed guidelines, as this date aligns with the effective date of IFRS 9. However, should there be any additional requirements in the future that may impact the effective date of IFRS 9, we recommend that the effective date of the proposed guidelines be updated accordingly, such that the date of application remains aligned with the effective date of IFRS 9.

[1] Page 57 of the proposed guidelines

Furthermore, the proposed extension of the guidelines to all credit institutions in the EU has an impact on the appropriateness of 1 January 2018 as the date of application. This is because smaller credit institutions may be required to undertake more work than they otherwise would have been expected to carry out, to comply with both the proposed guidelines and with IFRS 9 by 1 January 2018. This reinforces our view discussed in the cover letter that the proposed guidelines should only apply to systemically important and other large credit institutions.

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

As stated in the cover letter, we believe that more extensive guidance would be required around the concept of proportionality and how banks should apply it in practice. Proportionality is a concept more relevant and familiar to supervisors for the purposes of determining how they design and enforce regulations.

The credit institutions subject to the proposed guidelines cover a wide range of size, complexity and sophistication and hence a 'one size fits all' approach would not be appropriate. In addition, the population of credit institutions include large entities with both large and small loan portfolios, small credit institutions with both simple or complex operations, and foreign operations of credit institutions from outside the EU. The proposed guidelines do not make clear how proportionality would apply for these different types of institutions.

The proposed guidelines also recommend a proportionality approach whereby small credit instructions might place greater reliance on the use of practical expedients available under IFRS 9. In this regard, it is unclear as to what constitutes a small credit institution because the proposed guidelines do not specify any size thresholds. This may also result in the inconsistent application of the proposed guidelines when each individual credit institution makes this size assessment. There is also a lack of clarity and guidance as to whether and how smaller credit institutions should apply the concept of undue cost and effort when in possession of a limited information set, given the wording of paragraph 131 of the proposed guidelines. Overall, we think that smaller credit institutions in particular will find it challenging to comply with the proposed guidelines because of the lack of additional proportionality guidance. More specifically, we think that the proposed guidelines do not outline a detailed approach of how to assess proportionality, but nevertheless require all credit institutions to: comply with the proposed guidelines in a size-appropriate manner, achieve a high-quality implementation of the relevant expected credit loss (ECL) accounting framework, avoid bias when estimating ECL, and avoid delaying the recognition of ECL.

In the absence of wider and more detailed guidance on proportionality, the proposed guidelines might impose significant additional costs on smaller credit institutions that exceed the supposed benefits.

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?

As stated in the cover letter, to the extent that the proposed guidelines would apply only to systemically important or other large credit institutions in the EU that cover a large majority of total banking assets, we generally agree that they introduce the relevant BCBS Guidance into the EU regulatory framework.

However, we note that the proposed guidelines outline only the high-level changes[2] that have been made compared with the BCBS Guidance, but do not identify or explain other more detailed changes and the reasons therefor. These more detailed differences between the BCBS Guidance and the proposed guidelines include the following[3]:

Differences between the BCBS Guidance and the proposed guidelines	**Proposed guidelines paragraph**
Credit institutions' accounting policies should address, and its allowance methodology should include, criteria for (a) renegotiations/modifications of lending exposures due to financial difficulties or for other reasons, considering also the specific definitions of forbearance established in Commission Implementing Regulation (EU) 2015/227 amending Part 2 of Annex V.	41
~~*Typically*~~ [c]ustomers should demonstrate consistently satisfactory payment performance over a reasonable period of time before credit risk would be considered to have decreased considering also the relevant requirements for exposures in the probation period as defined in Commission Implementing Regulation (EU) 2015/227 paragraphs 176-178 amending Part 2 of Annex V.	41(a).ii
Credit institutions should consider in particular the following non-exhaustive list of indicators in assessing a significant increase in credit risk ….expectation of modification due to financial difficulties, including	107(f)

[2] Paragraph 14 of section 3 of the Consultation Paper.
[3] Relevant deleted text is struck through and relevant new text is underlined.

Differences between the BCBS Guidance and the proposed guidelines	**Proposed guidelines paragraph**
those qualifying as forbearance in accordance with Regulation (EU) 2015/227.	
A credit institution should maintain sufficient historical loss data, where available, covering a period in which a likely range of default rates is considered to have been experienced, to provide a meaningful analysis of its credit loss experience for use as a starting point when estimating the level of allowances on a collective or individual basis	33(k)
~~A bank should regularly (for example, annually) review its ECL models.~~	66

We are uncertain as to the EBA's intention behind the above changes made in the proposed guidelines - i.e. whether the guidance is intended to be different from the BCBS Guidance (in which case it should be explicitly stated) or not intended to be different (in which case the wording should adhere to the BCBS Guidance). To clarify this, we believe that it would be helpful if all changes made in the proposed guidelines, both additions and omissions, were highlighted and explained so that departures from the BCBS Guidance can be identified and understood. For example, we think that it should be clarified whether the references to Regulation (EU) 2015/227 in paragraph 41 of the proposed guidelines mean only that a bank should "consider" the requirements of the Regulation in making judgements about the application of IFRS 9, or whether those requirements must be applied to determine the staging assessment of modified assets under IFRS 9.

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.

We disagree with the baseline assertion included in the EBA Guidelines regarding the existence of an unlevel playing field across credit institutions at an international level, to the extent that other jurisdictions across the world apply the BCBS Guidance only to internationally active banks.

As noted in the cover letter, we also think that it is unclear as to what are the specific benefits of applying the proposed guidelines to all credit institutions in the EU. If the overall objective of introducing the proposed guidelines is to reduce the risk of financial system instability, then we believe this could be achieved by applying the guidelines to only those large credit institutions that hold a majority of total banking assets such as those banks that were subject to the recent EU-wide stress tests. Extending the application of the proposed guidelines beyond these large credit institutions would result in diminishing returns from a cost/benefit perspective, especially without more comprehensive guidance on proportionality for small credit institutions.