EBA-CP-2012-10@eba.europa.eu
European Banking Authority
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28 September 2012

Dear Sirs,

BBA response to EBA consultation paper on Draft Regulatory Technical Standards on the specification of the calculation of specific and general credit risk adjustments according to Article 105(4) of the draft Capital Requirements Regulation (CRR) (EBA/CP/2012/10).

The British Bankers' Association ("BBA") is the leading association for UK banking and financial services for the UK banking and financial services sector, speaking for over 220 banking members from 60 countries on the full range of the UK and international banking issues. All the major banking players in the UK are members of our association as are the large international EU banks, the US banks operating in the UK and financial entities from around the world. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum encompassing services and products as diverse as primary and secondary securities trading, insurance, investment banking and wealth management, as well as deposit taking and other conventional forms of banking.

The BBA is pleased to respond to the EBA consultation on the Draft Regulatory Technical Standards on the Calculation of Credit Risk Adjustments. Note, as this is a collective response on behalf of BBA members we have confined our answers to questions 1 – 5 of the consultation.

One issue, on which there is no question, but we would like to draw to your attention is implementation date. We have noted that draft RTS have indicated implementation dates that are shortly after entry into the Official Journal. While we appreciate that the EBA cannot influence the timing of the legislative process, once it has completed its draft standard we urge the EBA to recognise that firms need sufficient time to make the necessary systems changes; an approach based on a planned implementation date is easier for banks to manage.

Q1. Are the provisions included in this draft RTS on criteria that specify which amounts shall be included in the calculation of GCRAs or SCRAs respectively, sufficiently clear? Are there aspects which need to be elaborated further?

There is some ambiguity in the draft RTS, particularly in respect of the criteria which sets out to distinguish between General CRAs and Specific CRAs. As a principle, we share the EBA view that the distinction between GCRAs and SCRAs should follow the accounting framework/interpretation. In this respect, we think that the RTS could be more explicit in describing the distinction between SCRAs and GCRAs.

SCRAs should be associated with assets which have been subject to distinct *credit risk events*, such as missed payments or covenant breaches, including those which have not yet been reported, while GCRAs would relate to patterns of activity, behaviour or trends (such as movements in the economy), which are not themselves credit events. We acknowledge that the accounting framework is currently under revision and therefore suggest that there should be a provision in the Technical Standard that facilitates a review of the technical standard in light of such changes, assuming that it would be possible to do so within the confines of the Level 1 text.

Q2: Are there any issues regarding the timing of recognition of provisions, value adjustments or impairments in profit or loss and in Common Equity Tier 1 capital?

Members see the key issue in respect of the timing of recognition as the alignment of adjustments with the accounting framework of the firm. The timing of Capital adjustments and P&L charges should be synchronised.

Q3: Are the provisions included in this draft RTS on criteria to assign SCRAs for a group of exposures sufficiently clear? Are there aspects which need to be elaborated further?

Members support the EBA proposal to base the assignment of adjustments between Standardised and IRB portfolios on the basis of direct attribution of provisions relating exclusively to either standardised or advanced portfolios. For portfolios where both approaches are used, the allocation should be achieved by attribution on the basis of relative exposure values, as indicated by the text of the RTS. However, there seems to be some divergence between the text of the RTS and the consultation text on this issue.

On the grounds of computational efficiency, simplicity and transparency, our members have a strong preference for also using exposure or another suitable approach defined by an institution as the basis for assigning SCRAs to individual assets, rather than on the basis of risk weighted exposure (RWA), as proposed in the draft RTS. Assigning SCRAs on the basis of RWA, though attempting to align to risk, would be much more challenging from a computational point of view, potentially leading to the RWA calculation taking place twice (for example, where the Risk Weight is dependent on the level of provisions, as is the case for Past Due items under the standardised approach). It is not obvious that assigning SCRA on the more straightforward basis of exposure value (EAD) would result in a materially different outcome.

In the cost benefit analysis section of the consultation paper, it is indicated that the EBA considered the option of allowing firms to make their own determination. This option was rejected because it would not support convergence. However, allowing such an approach, with supervisory discussion of approach proposed, would allow EBA to gain intelligence on alternative methodologies, which could be streamlined over time. With the uncertainties over the timing and final rules within CRDIV more generally, a flexible approach on initial adoption would be welcomed.

Also, in the RTS we suggest that for increased clarity the ordering of paragraphs in Article 3 is changed. Paragraph 3, which covers the allocation of SCRA between exposures using the Standardised Approach and IRB Approach, should be moved to the start of the Article as this would in practice be the first process an institution would have to perform for SCRA allocation.

Q4: Are the provisions included in this draft RTS sufficiently clear? Are there aspects which need to be elaborated further?

Members feel that the provisions, which relate to the identification of SCRAs that are ascribed individually, are sufficiently clear.

Our members note that the objective of this RTS is to delineate adjustments relating to exposures in default (paragraph 3 of Article 5), due to Article 155 of the draft CRR which states that 'specific credit risk adjustments on exposures in default shall not be used to cover expected loss amounts on other exposures.'

This rule under Article 155 differs from the current CRD rule in force, and it will mean that in instances where the total SCRAs exceed expected losses for exposures in default, this excess will not be able to offset any shortfall of SCRAs and General Credit Risk Adjustments (GCRAs) against the expected losses for non defaulted exposures. In this situation, the SCRAs excess for exposures in default will count as Tier 2 capital (subject to a cap), while the shortfall of SCRAs plus GCRAs against expected losses for non defaulted exposures will be treated as a deduction from Common Equity Tier 1 (CET1). This has the following implications:

- It results in a clear disincentive to apply conservative approaches to the determination of specific credit risk adjustments (SCRAs), given that an excess of SCRAs compared to EL for defaulted exposures will only count as Tier 2 capital, whereas the profit and loss impact of increasing SCRAs reduces CET1. It does not seem appropriate that capital regulation should penalise the adoption of prudent approaches when setting provisions (SCRAs)
- It also can also disadvantage banks / firms in those EU jurisdictions using more prudent provisioning policies. Provisions rules at present are far from being harmonized, and associated potential differences in impact on capital position across EU jurisdictions should be avoided
- In addition, inconsistencies across EU countries in the application and interpretation of the definition of default; particularly in terms of unlikeliness to pay criteria, would result in differing impacts on the capital position of banks

Given the above, the ideal solution would be an amendment to the Level 1 text. However, we recognise that such an approach is outside the EBA's remit. Therefore we recommend that the EBA consider these negative impacts when assessing the application of this provision of the RTS.

Q5: Do you support the policy proposal, in particular to the preferred policy option (3), and the EBA's assessment that its impact is relatively immaterial to the CRR text? If not please explain why and provide estimates of such impacts whenever possible.

As above response to Q3, members believe that the benefits from option 3 are outweighed by the operational challenges that would be faced and the efficiencies that would be lost in achieving this solution and the potential for inappropriate allocation across exposures using the IRB Approach. Therefore members would choose option 2 or a specified option which states "assign the SCRA to single exposures of the group proportionally to the exposure amounts."

Yours faithfully,

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