



April 30, 2015

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel Switzerland

Re: Basel Committee on Banking Supervision Consultative Document – Guidance on accounting for expected credit losses

Dear Sirs:

The Clearing House Association L.L.C. (“**The Clearing House**”)¹ appreciates the opportunity to comment on the consultative document released by the Basel Committee on Banking Supervision (the “**Committee**”), titled “Guidance on Accounting for Expected Credit Losses” (the “**Proposal**”). The Clearing House supports the efforts of the Committee to issue guidance to reinforce and enhance sound credit risk practices by financial institutions as they relate to financial accounting and reporting, in connection with the implementation of the approach to estimating credit losses that was recently issued by the International Accounting Standards Board (“**IASB**”) and is currently proposed by the Financial Accounting Standards Board (“**FASB**”) (collectively, the “**Expected Credit Loss models**” or “**ECL**”).

As a conceptual matter, The Clearing House strongly supports the principles-based accounting approach generally taken in the Proposal to overseeing and encouraging the application of sound credit risk practices from a financial reporting perspective, which we believe is significantly more appropriate than a highly granular, prescriptive approach for reviewing the adequacy of a bank’s allowance for credit losses. We believe that ensuring the overall adequacy of the allowance should be the primary objective of the banking regulators.

¹ Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world’s largest commercial banks, which hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing — through regulatory comment letters, amicus briefs and white papers — the interests of its owner banks on a variety of important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily, which represents nearly half of the automated clearing-house, funds transfer, and check-image payments made in the United States. See The Clearing House’s web page at www.theclearinghouse.org.

We have attempted to provide as much meaningful commentary on the Proposal as possible but we believe that finalization of the Proposal at this time is premature given the FASB has yet to issue a final standard. As a result, we cannot comment comprehensively on the Proposal, and we therefore respectfully request that finalization of the Proposal and its implementation in the United States be delayed until the FASB issues a final standard. In this regard, we note that accounting guidance related to the loan loss allowance already exists in the U.S., the general principles of which appear to be consistent with the Proposal. Given the length of the expected implementation period for the FASB ECL model, we respectfully request that the Committee solicit additional comments regarding the Proposal once the FASB ECL model is finalized. Should the Committee feel that interim guidance is needed at this time for international institutions that are subject to International Financial Reporting Standards (“IFRS”), we suggest that the guidance be explicitly labeled and limited as such.

Executive Summary

As described in detail in this letter, our principal suggestions and recommendations are as follows:

- A. The Committee’s guidance should clarify that inputs and assumptions used in developing regulatory capital should not be the same as those used for accounting measures given that the objectives of the two measures are fundamentally different.
 - B. The Committee’s guidance should allow banks to consider information that is relevant and reasonably available for accounting measures; practical expedients should be permitted as appropriate.
 - C. The Committee should expressly acknowledge that certain guidance related to the grouping and rebalancing of credit exposures may not be relevant to U.S. banks.
 - D. The Committee should work with other official standard-setting agencies to ensure that the disclosure requirements promulgated by them are appropriate from a bank regulatory perspective, and should not issue separate guidance covering the same topics, which may result in duplicative or overlapping disclosures that complicate, rather than clarify, the information provided to investors.
- A. The Proposal should clarify that inputs and assumptions used in developing regulatory capital should not be the same as those used for accounting measures given that the objectives of the two measures are fundamentally different.**

Paragraph 8 of the Objective and Scope section of the Proposal clearly acknowledges that there are fundamental differences between the measurement of expected losses for regulatory capital purposes and the measurement of losses for accounting purposes, given that the objectives of the two measures are different. As the Proposal correctly notes, “the Basel capital framework’s expected loss calculation for regulatory capital, as currently stated, differs from accounting requirements in that the Basel capital framework’s probability of default is through the cycle and is always based on a 12-month time horizon.” Additionally, the Basel capital framework’s loss given default reflects downturn economic conditions and stressed scenarios developed for regulatory purposes and should not be used for accounting purposes, as this would be inconsistent with the ECL model. Elsewhere in the Proposal, however, the distinction between regulatory capital measures and the measurement of ECL for

accounting purposes is less clear. For example, in Principle 2, paragraph 21 states that “[t]he Committee expects banks to **maximise the extent to which underlying information and assumptions are used consistently** within a bank to determine when credit should be granted and its corresponding terms; monitor credit quality; and **measure allowances for both accounting and capital adequacy purposes**. Using the **same information and assumptions** across a bank to the maximum extent possible reduces bias and encourages consistency in interpretation and application of the applicable accounting framework.” (Emphasis added).

In Principle 6, paragraph 64, the Proposal states that “Additionally, banks are increasingly considering a wide range of information, including that of a forward-looking nature, for risk management and capital adequacy purposes. The **Committee expects banks to avail themselves of such information** and the processes followed to obtain it, for accounting purposes.” Paragraph 69 elaborates that “because banks are increasingly considering forward-looking information and macroeconomic factors for risk management and capital adequacy purposes, **the Committee expects banks to leverage and integrate these processes to the extent possible** when developing their processes for estimating ECL for accounting purposes. **Nevertheless, for banks that calculate expected losses under the Basel capital framework, the Committee acknowledges that adjustments will be needed to these expected loss calculations when estimating ECL for accounting purposes and expects that these adjustments will be well documented.**” (All emphases added).

While we strongly agree that banks should leverage information regarding forward-looking scenarios and macro-economic factors for accounting purposes, we are concerned that the emphasis on using this information consistently within a bank for accounting and other purposes could be misinterpreted. Accordingly, we recommend that the Proposal be consistent throughout in acknowledging that the measures and scenarios developed by a bank for regulatory capital purposes should not be used for accounting purposes without appropriate adjustment. In addition, we believe that the requirement to document why certain assumptions that were used for risk management and capital adequacy purposes were not used for measuring ECL is also inappropriate.

On a similar note, footnote 19 to paragraph 30 states that “forward-looking information and related factors affecting the allowance should be consistent with the information used in scenarios used to estimate cash flow expectations for goodwill or other asset impairment testing.” We believe that the impairment tests developed for goodwill and other long-lived assets under U.S. GAAP and IFRS have fundamentally different objectives from the ECL model. For example, the initial assessment of goodwill under U.S. GAAP is a determination of whether it is more likely than not that the fair value of a reporting unit is less than its carrying value, and the first step in testing goodwill for impairment involves estimating the fair value of a reporting unit. The assumptions used to determine the fair value of a reporting unit would very likely be different from cash flow assumptions and other factors associated with assessing the loan portfolio under the ECL model. Accordingly, we do not agree with a statement that the assumptions for all of these impairment tests should be consistent.

B. Banks should consider information that is relevant and reasonably available for accounting measures; practical expedients should be permitted as appropriate.

Principle 2, paragraph 30 states that banks should consider the “full spectrum” of information that is relevant to the product when performing complex scenario simulations. We are concerned that the phrase “full spectrum” is very open-ended and could be interpreted to mean a more complex

scenario analysis is expected than is currently required for accounting purposes. Furthermore, we are concerned that it could lead to “second guessing” of accounting determinations, i.e., being challenged after the fact as to why a particular scenario was not considered by a bank.

In addition, Principle 6, paragraph 60 states that the costs of obtaining macro-economic factors and forward-looking information should not be avoided on the basis that a bank considers them to be excessive or unnecessary. In this regard, we note that IFRS 9 requires an entity to consider “reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions” and “that is relevant to the estimate of ECLs.”² We strongly encourage the Proposal to adopt this same accounting standard for banks because it appropriately balances the cost of obtaining information with the benefits derived therefrom, and because we believe it would be imprudent for banks to disregard the costs of obtaining information. The overall goal should, of course, remain that of achieving a high-quality, robust implementation of the relevant ECL model.

Similarly, the Proposal provides in several places that the use of practical expedients should be limited by large sophisticated banks and that their use equates to a “very low-quality implementation” of the ECL model. For example, paragraph 15 indicates that internationally active banks should limit the use of practical expedients; section 3 of the Appendix elaborates on this point. In this regard, we note that it is expected that the FASB’s ECL model will explicitly permit practical expedients when appropriate, including the use of different loss models (such as the use of loss rates vs. expected cash flow or migration models), and the consideration of discounting, and thus we are concerned that the Proposal may ultimately contradict the FASB’s final standard. More broadly, however, we believe that the application of practical expedients is not necessarily inconsistent with a robust application of the ECL framework and, where used judiciously and prudently, without sacrificing the overall quality of the impairment assessment, should be permitted. Accordingly, we recommend that the Proposal refrain from categorically prohibiting the use of all practical expedients by large, international banks.

Finally, paragraphs 24(d) and (e) imply that a process must be in place to determine “the most appropriate method” in measuring the allowance. We are concerned that this means that all methods must be considered by a bank before a final method is selected, and that the documentation required to demonstrate that other methods were considered and the reasons for which they were rejected will be overly cumbersome for many banks. We recommend that the Committee clarify that banks document the rationale for why they believe the method chosen is the most appropriate method to estimate ECL and do not necessarily have to document why alternative measures were not selected.

C. Certain guidance on grouping and rebalancing credit exposures may not be as relevant to U.S. banks for accounting purposes.

² IFRS 9, paragraph B5.5.55.

Paragraphs 43 through 48 discuss grouping credit exposures by shared credit characteristics and emphasizes the need for regular rebalancing to properly assess whether there has been a significant deterioration in credit quality under IFRS 9. While it may be prudent to rebalance credit exposures under certain economic conditions to better estimate ECLs, the need to rebalance credit exposures may be less frequent under U.S. GAAP as the FASB's proposed ECL requires a lifetime ECL estimate for all credit exposures. As a result, some of this guidance may not be relevant to banks that apply U.S. GAAP. We encourage the Committee to acknowledge that the use of management judgment is an important factor in determining the appropriate grouping and rebalancing of credit exposure.

D. The Committee should work with other official standard-setting agencies to ensure that the disclosure requirements promulgated by them are appropriate from a bank regulatory perspective, and should not issue separate guidance covering the same disclosure topics, which is likely to result in duplicative or overlapping disclosures that complicate, rather than clarify, the information provided to investors.

The Proposal sets forth certain expectations regarding additional disclosures by banks regarding the ECL estimates. For example, paragraphs 75 and 76 provide (all emphases added):

75....The Committee expects quantitative and qualitative disclosures, taken together, to provide a clear picture to users of the main assumptions used to develop ECL estimates, and **the sensitivity of ECL estimates to changes in those assumptions**. Additionally, the Committee expects disclosures to highlight policies and definitions that are integral to the estimation of ECL (such as a bank's basis for grouping lending exposures into portfolios with similar credit risk characteristics and its definition of default, which the Committee expects to be guided by the definition used for regulatory purposes), factors that influence changes in ECL estimates, and how the process incorporates management's experienced credit judgment.

76. The move to an ECL model requires that forward-looking information and macroeconomic factors be incorporated into estimates of ECL. **The Committee expects banks to provide qualitative disclosures on how these have been incorporated into the estimation process and quantitative information on how changes in forward-looking information and macroeconomic factors have affected ECL estimates.**³

While it is unclear as to where specifically the Committee expects this information to be disclosed, we note that these additional disclosure requirements are well beyond the disclosures required by IFRS, which have only recently been issued. In addition, we note that FASB is still in the process of deliberating its disclosure requirements regarding its ECL model.

³ References to similar proposed disclosures can also be found in paragraphs 29, 30 and 79 of the Proposal.

Furthermore, we note that the IASB, FASB and the Securities and Exchange Commission (“SEC”) all have major projects pending on their agendas regarding the overall framework of disclosures, in an effort to simplify and streamline the current set of required financial statement disclosures. In addition, the new Pillar 3 disclosures require a significant amount of information regarding inputs and assumptions underlying the allowance. These disclosures, combined with the numerous existing disclosures regarding the allowance for loan losses and the credit risk quality of loans, should enable users to perform their own sensitivity analysis, which we believe is a superior method of conveying this information to investors.

We are concerned, that by layering additional disclosures onto the IASB and FASB requirements, the Committee will inadvertently promote the proliferation of duplicative and/or overlapping disclosures. We are concerned that this type of piecemeal approach to developing disclosures ultimately may end up confusing, rather than clarifying, the information provided to investors. Accordingly, we strongly suggest that the Committee work in close cooperation with the SEC, FASB, IASB and other official standard-setting agencies to influence the disclosure requirements promulgated by them, and refrain from issuing its own, separate requirements, to avoid unnecessarily complicating the financial statement disclosures.

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In conclusion, we support the Committee’s efforts to provide guidance on the prudential oversight and robust application of the ECL model. We hope that you find our suggestions regarding areas of focus and improvement as they relate to financial accounting and reporting useful. We would be happy to meet with you to discuss these suggestions in more detail, or provide additional thoughts on any of our individual recommendations. If you have any questions, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org) or Ryan Pozin at (212) 613-0135 (email: ryan.pozin@theclearinghouse.org).

Sincerely yours,



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