



April 28, 2015

Mr. Stefan Ingves
Chairman
Basel Committee on Banking Supervision
Basel, Switzerland

Reference: Consultative Document – *Guidance on Accounting for Expected Credit Losses*

Dear Mr. Ingves:

The Mortgage Bankers Association¹ (MBA) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's (Basel Committee) Consultative Document titled *Guidance on Accounting for Expected Credit Losses* (Consultative Document).² The following is background information on accounting principles related to accounting for credit impairment followed by MBA's general comments.

Background

In 2009, the G 20 group recommended that accounting standard setters move from the incurred loss model to an expected credit loss (ECL) model in order to facilitate banks having greater allowances for credit losses in advance of a credit cycle like the one that occurred in 2007 and 2008. An incurred loss model is a regime for recording an allowance only once there is some evidence of impairment. In contrast, a pure expected loss model is one where the reporting entity records allowances for losses based upon losses expected during the life of the loan.

The Financial Accounting Standard Board (FASB) and the International Accounting Standards Board (IASB) previously agreed with the objective of achieving international accounting standards convergence on accounting principles in key areas, including

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mba.org.

² Basel Committee on Bank Supervision, Consultative Document, Standards, Revisions to the Standardized Approach for Credit Risk, December 2014.

recognizing impairment of financial instruments. For several years the FASB and the IASB worked together to develop a credit impairment regime based upon recording expected losses not incurred losses. However, several years ago, the FASB and the IASB “agreed to disagree” and went their separate ways in their approaches to recognizing expected losses.

The FASB’s model, which is expected to be finalized in the next few months, calls for reporting entities to record life of loan expected losses on day 1 – when loans are originated or purchased. FASB’s proposal will remove “probable” and “incurred” thresholds for recognition of credit losses, extend the time horizon over which “expectations” are to be formed to life of loan, and be more forward-looking by incorporating reasonable and supportable forecasts of the future. The FASB’s model would require reporting entities to use past and present information as well as forward looking economic forecasts to project such losses. For long-term assets like mortgages and mortgage-backed securities (MBS), FASB expects reporting entities to use historic loss information for periods beyond supportable economic forecast ranges.

The IASB model would require reporting entities to record life of loan losses for loans the reporting entity expects to have evidence of significant credit impairment over the subsequent 12 months. The IASB model requires loans to be classified in one of three “stages,” and the stages relate to the level of impairment evidence. Stage 1 includes financial instruments that have not had a significant increase in credit risk since initial recognition or that have low credit risk at the reporting date. Stage 2 includes financial instruments that have had a significant increase in credit risk since initial recognition but do not have objective evidence of impairment. Stage 3 is for financial instruments that have objective evidence of impairment at the reporting date. Each stage has its own accounting regime.

In its previous comment letters to the FASB and the IASB on their respective approaches MBA noted:

- The expected loss model does not follow the “matching principle” of accounting whereby reporting entities should attempt to match the timing of reporting related revenues and expenses (in this case interest income and credit losses).
- FASB’s model is more operational than IASB’s – in terms of initial and ongoing implementation.
- The IASB’s model will involve much more subjectivity as assets move to and from the three stages.
- FASB’s model is probably closer to the G 20’s recommendation of front-loading recognition of credit losses.

General Comments, Issues, and Questions

MBA does not disagree with any of the eleven principles found on pages 1 and 2 of the Consultative Document. However, we have the following comments, issues and questions we would like you to consider.

Overarching Comment – Why So Little Attention to FASB’s Proposal?

The Consultative Document does acknowledge the lack of accounting convergence between the FASB and the IASB on page 2, item 3, “With regard to consistency, the Committee recognizes that differences exist between ECL accounting frameworks, across jurisdictions. The revised guidance does not intend to drive convergence between these accounting frameworks, but does aim to drive consistent interpretations and practices, where there are commonalities and when the same accounting framework is applied.” However, it is silent as to what those differences are, and it has a special appendix specific to the IFRS requirements. MBA strongly recommends that the Basel Committee wait to release the final principles document until the FASB releases its final credit impairment update in the next few months. At that time, the Basel Committee should have a section in the final principles pronouncement that discusses the differences in approach of the two frameworks and draft a special appendix for the FASB’s regime that is similar in nature to the appendix for the IFRS’s standard. Further, the Consultative Document contains criticisms for certain practical expedients contained in the existing IFRS model. The final pronouncement should also contain similar analysis (pros and cons) of the FASB model that it wants globally active banks to be aware of.

The largest issue remains – how will the financial statements and regulatory regimes be comparable for globally active banks when the underlying accounting rules are vastly different on accounting for financial instruments?

MBA Agrees With “Proportional Approach”

On Page 4, item 12 in the Consultative Document the Basel Committee states, “For less complex banks, consistent with the Basel Core Principles, the Committee recognises that supervisors may adopt a proportionate approach with regard to the standards that supervisors impose on banks and the conduct of supervisors in the discharge of their own responsibilities. This allows less complex banks to adopt approaches commensurate with the size, nature and complexity of their lending exposures.”

Although the United States has its share of large, globally active banks, it has a total of 6,430³ banks. Thus, the vast majority of our banks are small, community-based banks and savings and loan associations. The concept of proportional approach to adopting standards allows community banks to compete with larger banks without falling into the “too small to comply” trap with respect to the continual layering of additional rules and regulations. MBA endorses this approach in the Consultative Document.

³ FDIC, *Institutions Directory*, information obtained from database on 4/16/2015.

Exclusion of Debt Securities from the Consultative Document

On page 4, item 13 of the Consultative Document, the Basel Committee excludes from the scope debt securities. MBA points out that the latest drafts of the FASB's credit impairment principles includes in the scope all debt securities that are classified as held-to-maturity and carried at amortized cost. MBA believes that the Basel Committee should include in the scope of its final principles document all financial instruments carried at amortized cost.

Limit on Use of Practical Expedients

The Basel Committee proposes to limit the use of practical expedients that accounting standards setters put into their respective credit impairment accounting principles. On page 4, item 15, the Consultative Document states, "...the paper is intended to set forth supervisory requirements for ECL accounting that do not contradict the applicable accounting standards established by the IASB or other standard setters. Rather, the paper presents the Committee's view of the robust application of those standards, including circumstances in which the Committee expects internationally active banks to limit their use of particular simplifications and/or practical expedients included in the relevant accounting standards."

MBA points out that accounting standard setters weigh the pros and cons of practical expedients included in accounting standards, and MBA believe that such expedients should be available to banks of all sizes.

Use of Internal Audit

Page 6, item (d) of the Consultative document puts internal audit into the role of independently evaluating the effectiveness of the bank's credit risk assessment and measurement systems and processes, including the credit risk weighting system. Are typical internal auditors sufficiently trained to do this? Many banks have an independent credit risk function that may be better trained to perform this function. MBA suggests that the Basel Committee broaden the recommendation and not limit it to just internal audit. The phrase on page 8, item (o) is more appropriate, "require that analyses, estimates, reviews and other tasks/processes that act as an input or output to the credit risk assessment and measurement process are performed by competent and well trained personnel who are independent of the bank's lending activities."

Monitoring Credit Risk Migration

Page 14, paragraph 49 of the Consultative Document appears to favor the IASB's three stages approach for recognition of impairment. It states, "Banks should implement

sound and robust credit risk methodologies with the objective that the overall balance of allowances is developed in accordance with the applicable accounting framework and appropriately reflects ECLs. This requires that banks identify as early as possible any changes in credit risk and report increases in credit risk (also known as credit risk migration) through the allowance account.”

The FASB’s framework is to recognize life of loan expected credit losses upon origination or purchase of the financial asset not upon increasing evidence of the potential for default. It also requires the reporting entity to monitor changes in the performance of the loan, the macroeconomic economic environment, and other factors that impact the probability of default and loss severity upon default parameters. Those using the FASB regime will not have to track changes through stages, reporting losses once stage 2 or stage 3 events occur. The Basel Committee should wait until the final FASB standard is issued and update the language in the principles document to show no bias toward either the IASB or FASB standards.

MBA appreciates the opportunity to share its observations with you. Any questions about the information provided herein should be directed to Jim Gross, Vice President Financial Accounting and Public Policy and Staff Representative to MBA’s Financial Management Committee, at jgross@mba.org.

Sincerely,

A handwritten signature in black ink, appearing to read "D.H. Stevens". The signature is stylized and cursive.

David H. Stevens
President and Chief Executive Officer
Mortgage Bankers Association