PRESENTATION OF THE HIGH-LEVEL CONFERENCE "THE NEW BANK PROVISIONING STANDARDS: IMPLEMENTATION CHALLENGES AND FINANCIAL STABILITY IMPLICATIONS"

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The Conference on the new bank provisioning standards, jointly organised by the Banco de España, the Centro de Estudios Monetarios y Financieros (CEMFI) and the Financial Stability Institute of the Bank for International Settlements, was held at the Banco de España's headquarters in Madrid on 18-19 October 2018.

The Conference was opened by Pablo Hernández de Cos, Governor of the Banco de España, and the keynote speaker was Steven Maijoor, Chair of the European Securities and Markets Authority. It was structured around five sessions followed by open discussions. Chairs and panellists were leading international figures from academia, the banking industry, and accounting, auditing and supervisory institutions.[1]

Governor Hernández de Cos highlighted "…the relevance of the conference, given the importance of the correct measurement of credit risk. In this regard, the correct calculation of provisions plays a crucial role in the way banks manage appropriately their credit risk. A consistent level of provisions according to the risk profile of each bank will prevent any undesired impact on solvency levels, which would be the final resource to absorb any loss arising from the ordinary activity of banks that has not been eliminated before by the correct application of provisions. In addition, appropriate macroprudential tools in the hands of policy-makers might help reduce the volatility of credit and business cycles… Learning from the implications and interactions between the new provisioning standards and other types of regulations to which banks are subject – most notably financial market regulations and micro- and macro-prudential regulations – will prove a perfect topic for the final panel of the conference. In this regard, the Banco de España experience[2] with the setting-up of so-called dynamic provisioning,[3] which shares many characteristics with the current countercyclical capital buffer and is close to the concept of the expected loss model, serves as a good example of how closely linked provisioning standards, capital and macroprudential policies are. From a financial stability perspective, the fact that supervisors are given macroprudential tools should allow us to deal better with lending expansions and contractions in order to protect the economy from financial excesses."

Steven Maijoor, in his speech entitled "Better to be good and on time than perfect and late: replacing incurred loss by expected loss", stated that "…the change of the impairment model from the incurred loss to the expected loss marks a new paradigm. In my view, this change, at least partially, addresses the long acknowledged deficiency of accounting standards ("too little too late") that manifested itself during the recent financial crisis and thus responds to the G20 mandate. This new paradigm allows earlier

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1 The programme is available at https://www.bde.es/f/webbde/INF/MenuHorizontal/SobreElBanco/Conferencias/2018/Agenda_Oct2018.pdf.

2 See J. Saurina and C. Trucharte (2017), *The Countercyclical Provisions of the Banco de España 2000-2016,* for an account of the history of the dynamic provisions in Spain, their impact and lessons drawn for prudential policy.

3 See G. Jiménez, S. Ongena, J. L. Peydró, and J. Saurina (2017), "Macroprudential Policy, Countercyclical Bank Capital Buffers, and Credit Supply: Evidence from the Spanish Dynamic Provisioning Experiments", *Journal of Political Economy,* 125(6), for a thorough quantitative analysis of the countercyclical impact of dynamic provisions in Spain. A broader discussion of the interaction of dynamic provisions with monetary, fiscal and regulatory policy is in Á. Estrada and J. Saurina (2016), "Spanish Boom-Bust and Macroprudential Policy", *Financial Stability Review,* No. 30, Banco de España.

recognition of losses and considers a broader range of forward-looking information in accounting provisions. However, the new provisioning model makes accounting for credit loss provisions more complex and introduces an additional layer of management judgment as well as discretion in estimating the forward-looking expected credit losses. This increased complexity and reliance on judgments will pose additional challenges in assessing objectively the provisioning approaches by external auditors but also by banking supervisors and accounting enforcers."

Here is a short summary of the main issues presented in the five panels.

Session 1 was chaired by Fernando Restoy, and the panellists were Anne Beatty, Ohio State University, Amaro Gomes, International Accounting Standards Board, and Dina M. Maher, Federal Reserve Bank of New York. The panel focused on the evolution of the standards from the incurred loss to the expected loss approach. It offered a perspective on the process that led to the new standards, covering issues such as why and how the provisioning model has changed, the pros and cons of the alternative approaches, and the rationale for the differences between IFRS 9 and the incoming US GAAP.

Session 2 was chaired by Rafael Repullo, and the panellists were Juan Carlos García Céspedes, BBVA, Manuele Iorio, Price Waterhouse Coopers, and Stephen G. Ryan, Stern School of Business. The panel focused on the modelling challenges for the banking industry associated with the new standards, covering issues such as the differences and relationship between the models needed to compute the new provisions and the models already in use for regulatory purposes or for internal credit risk management, technical aspects that still need to be developed, data gaps, and the special challenges for small lenders or for specific market segments.

Session 3 was chaired by José María Roldán, Spanish Banking Association, and the panellists were Adam Farkas, European Banking Authority, Manuel Pérez de Castro, Banco Santander, and Raihan Zamil, Bank for International Settlements. The panel focused on model complexity and supervisory capabilities, including compliance costs, the extent to which banking organisations are prepared to reliably report under the new standards, the implications of model complexity for the accuracy and comparability of financial statements across institutions and over time, and the implications for internal organisation, risk management, product pricing, as well as for auditors and market and prudential supervisors.

Session 4 was chaired by Jesús Saurina, and the panellists were Claudio Borio, Bank for International Settlements, Pablo Pérez, Financial Stability Board, and Javier Suárez, CEMFI. The panel discussed the time dimension of bank provisioning standards from the perspective of financial stability, with special focus on their potential contribution to pro-cyclicality. Will the expected credit loss approaches behind the new standards help reduce the cyclicality of bank profits, bank capital and credit supply? Are there aspects of the new standards requiring a potential adjustment at the micro- or macro-prudential level?

Session 5 was chaired by Ana María Martínez-Pina, Spanish Stock Exchange Commission, and the panellists were Germán López Espinosa, Universidad de Navarra, Alison Scott, Bank of England, and Fernando Vargas, Banco de España. The panel featured an interesting debate on the interactions between the new provisioning standards and the wealth of regulations banks are subject to. Topics discussed included the role of disclosures regarding the measurement of credit losses, whether auditors would be able to validate the models used by banks, would bank capital be significantly affected by the new provisions, and should regulatory capital requirements be revised in any form to accommodate the new provisions.

This issue of the *Financial Stability Review* contains two contributions from the Conference by Claudio Borio and Juan Carlos García Céspedes, along with the perspective offered by Jorge Pallarés Sanchidrián and Carlos José Rodríguez García, micro-prudential supervisors from the Banco de España.