

Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee



TERMS OF REFERENCE

Project: Loan loss provisioning in view of IFRS application

Project Owner: NBR Senior Manager

Project Manager: NBR manager

Deputy Project Manager: a bank's manager, Head of the RBA Accounting or Fiscal Technical Committees

I- Background

Currently, most of the Romanian banks calculate provisions according to both NBR Regulation no. 5/2002 and to IFRS for reporting to their mother entities.

Under Regulation no. 5/2002, provisions are calculated at individual level, for exposures classified in 5 categories (upon debt service, financial standing and legal status criteria), after deducting the collateral, and by applying the corresponding provisioning ratios. The exposures classified as loss are 100% provisioned and registered off balance sheet.

Under IFRS provisions are calculated both at individual and at portfolio level (based on loss and recovery historical rates), using a 10 categories classification, based on additional criteria such as commercial and ownership status. The exposures classified as "loss" are kept in the balance and not provisioned 100% (recognizing thus the collateral quality). The provisions are actually calculated as the net present value of future recoveries, discounted at the original effective interest rates on the loans.

Banks generally appreciate that provisions calculated under IFRS at portfolio level are higher than the ones calculated according to NBR regulation, although in some cases NBR methodology results in higher provisions¹.

The loan loss provisions are considered deductible for the calculation of the profit before taxation only up to the limits given by the NBR regulation. In case provisions are exceeding the limits fiscally recognized, there is a temporary deductible difference for which a deferred tax asset is to be recognized.

¹ According to Roland Berger study developed for RZB Romania, BRD – GSG and Bancpost.

The double loan loss provision calculation and reporting as well as the unclear fiscal treatment of the provisions calculated under IFRS results into increased compliance costs and financial planning uncertainty.

This duplication will persist unless the related regulations change in order to align economic, prudential, and tax treatment of credit risk.

II - Project Objective

Prepare a summary document on a feasible update of NBR prudential standards to reflect new accounting standards that would meet both business reality and supervisory objectives.

III – Intended Strategy

The project management group (Project Owner, Project Manager, Deputy Project Manager supported by the SPI Secretariat) acts based on the mandate received from the SPI Committee to identify and agree on a feasible update of NBR prudential standards to reflect new accounting standards that would meet both business reality and supervisory objectives.

The PWG will gather representatives from the relevant authorities (NBR and MOPF), as well as from the banking community. The presence of the latter ensures that the PWG will benefit from the hands on experience of banks in applying the IFRS and that the proposed solution will address the banks' concerns regarding the reporting burden and associated compliance costs generated under the double reporting system.

PM/DPM will ensure that PWG members reach the same level of understanding on the IFRS regarding loan loss provisioning by circulating a summary document prepared by the PM/DPM/SPI Secretariat containing a description of the IFRS standards requirements and the CEBS guidelines on common reporting on provisions.

PM/DPM/SPI Secretariat will ask the banks participating in the PWG to provide a description of the application of their home supervisory provisioning regulations based on IFRS standards. Likewise, the PM/DPM/SPI Secretariat will ask the NBR to provide their own intended approach to regulate provisioning requirements under IFRS. PM/DPM/SPI Secretariat will ask the MoPF to provide an overview of the preparations for IFRS implementation.

PWG members will analyze the common elements and the differences in approach amongst IFRS-based home supervisory regulations aiming at the need for consistency between prudential and accounting standards. Based on this, the PWG will write a proposal on a feasible update of NBR prudential standards to reflect new accounting standards while meeting prudential objectives. The SPI Secretariat will support the PWG proposal with a RIA on the prudential and tax impact assessment of the proposed new NBR regulation versus the regulations applied to the parent entities of Romanian banks.

IV- Methodology: from kick off to the accomplishment of the project

Preparation on the PWG first meeting (November 6 - 20)

PM/DPM/SPI Secretariat will prepare and send to PWG members a summary document containing a description of the standards requirements and a presentation of CEBS guidelines on common reporting regarding provisions and will ask:

- PWG bank members to provide a description of the application of the IFRS standards on provisioning according to home supervisory treatments;
- PWG NBR members to provide a supervisory perspective on the application of provisioning requirements under IFRS;
- MoPF to provide an overview of the preparations for IFRS implementation.

SPI Secretariat will gather the individual contributions and centralize them in a document.

PO/PM will send to the PWG members the SPI Committee Mandate Letter together with the following documents before the PWG 1st meeting:

1. document based on individual contributions;
2. Draft TORs prepared by SPI Secretariat and endorsed by PO and PM/DPM.

PWG first meeting - November 20 - 24

1. PWG members discuss the document and analyze the common elements and the differences in approach amongst IFRS-based home supervisory regulations and how they ensure consistency between the accounting standards and prudential requirements.
2. PWG members agree on the ToRs.
3. PM/DPM establish ***homework for PWG members***: write a proposal on the principles of a feasible update of NBR prudential standards to reflect new accounting standards while meeting prudential objectives.

SPI Secretariat helps PM/DPM to gather all the individual contributions provided by PWG members in a centralized document to be on the table for discussions at the second meeting.

PWG second meeting – December 18 - 22

1. PWG members discuss the centralized document and agree on the principles of a solution acceptable for all the involved parties.
2. PM/DPM establish ***homework*** for PWG members: NBR PWG members write up the document on the solution acceptable for all parties, outlining the consistency of the prudential requirements with the accounting standards.

SPI Secretariat prepares RIA questionnaire for assessing the impact of the proposed regulation versus the regulations applied to the parent entities of Romanian banks.

PWG third meeting – January 22 - 26

1. PWG members discuss and approve the document regarding the accepted solution.
2. PWG members approve the RIA questionnaire.
3. PM/DPM establish **homework** for PWG members: NBR PWG members draft the proposed regulation.

SPI Secretariat performs RIA calculations and sends the findings to PWG members. PM/DPM/SPI Secretariat send the regulation draft to PWG members.

PWG forth meeting – February 19 - 24

1. PWG members discuss and approve draft of the proposed regulation.’
2. PWG members discuss and validate RIA findings.
3. PWG members review and approve the summary document on the proposed solution.

V- Output

PWG first meeting:

- PWG members discuss the document and analyze the common elements and the differences in approach amongst IFRS-based home supervisory regulations and how they ensure consistency between the accounting standards and prudential requirements.
- PWG members write proposals on the principles of a feasible update of NBR prudential standards to reflect new accounting standards while meeting prudential objectives.

PWG second meeting:

- PM/DPM gathers all the individual contributions provided by PWG members in a centralized document gathering proposals on the principles of a feasible update of NBR prudential standards to reflect new accounting standards while meeting prudential objectives.
- NBR PWG members write up the document on the solution acceptable for all parties, outlining the consistency of the prudential requirements with the accounting standards. MoPF PWG members issue opinion on the tax implications of the accepted solution.

PWG third meeting:

- PWG members discuss and approve the document regarding the accepted solution.
- NBR PWG members draft the proposed regulation.

PWG fourth meeting:

- PWG members discuss and approve draft of the proposed regulation.’
- PWG members discuss and validate RIA findings.
- PWG members review and approve the summary document on the proposed solution.

VI - Project Team

NBR:

- 2 experts from the Regulation and Licensing Department.

Banks:

- 2 experts from the RBA Accounting and Fiscal Technical Committees

MoPF:

- 2 experts from the Accounting and Fiscal Departments.

PM will be a NBR manager from either the Regulation and Licensing Department or from the Accounting and Reporting Department.

DPM will be the Head of either RBA Accounting or Fiscal Technical Committees.

PM/DPM will report periodically to PO.

Technical Anchor: Financial sector regulator with Basel II and IFRS background.