Convergence Romania Financial Sector Modernization

Special Projects Public-Private Initiative Steering Committee

IFRS Provisioning

http://www.spi-romania.eu/program-2007/ifrs-loan-loss-provisioning/

SPI Committee Meeting
July 25, 2007

Project Objective:

Write a set of principles commonly agreed by the relevant stakeholders (NBR-banks-MEF) on a feasible update of the prudential requirements that would meet supervisory objectives and reflect the IFRS standards.

Project Working Group Activities

PWG Members: 14

PWG Meetings: 6

Public stakeholders

- National Bank of Romania;
- Ministry of Economy and Finance.

Private stakeholders

- Banking sector (5 banks).

Project Main Steps

Jan. 2007: Project Strategy Meeting defining the project objective
Feb. 2007: Project technical anchor (TAN) and peer reviewer (PR) are identified
Apr. 2007: Workshop on International Experience with Provisioning in View of IFRS and Basel II Implementation
Apr. 2007: With the support of the project TAN and PR the NBR outlines a possible approach for the new regulation
June 2007: The general principles for the new regulation are outlined by NBR and discussed with banks;
July 2007: The general principles are discussed with TAN. A full impact assessment is initiated to support MEF's decision regarding the fiscal treatment of the provisions according to the new regulations.

Summary of Preliminary Impact Assessment (Full RIA Underway):

Banks: RON 177 mil. (5 year NPV) from eliminating double reporting of provisions

For more information, please contact:
1. SPI Secretariat: Ms. Oana Nedelescu, Ramona Bratu, tel: +40 21 323 66 10; e-mail: oana.nedelescu@convergence-see.eu, ramona.bratu@convergence-see.eu
2. Project Management Group: Ms. Oana Balanescu, NBR, tel: +40 21 313 04 10; e-mail: oana.balanescu@bnro.ro .

IFRS Provisioning

Abstract

Appendices

Abstract

The SPI Committee approved the undertaking of the SPI Project on IFRS Provisioning on September 14, 2006. The project's objective was to "*write a set of principles commonly agreed by the relevant stakeholders (NBR-banks-MEF) on a feasible update of the prudential requirements that would meet supervisory objectives and reflect the IFRS and Basel II standards*".

The project has been placed under the ownership of Ms. Veronica Raducanescu, on behalf of the NBR. The working group comprised 14 experts from the NBR, banks and MEF. Meetings between the project working group members have been held between January 18th and July 4th, 2007. Also, a workshop on the International Experience with Provisioning in View of IFRS and Basel II Implementation has been held in April 12, 2007[1], in order to support the project working group in deepening its understanding of international best practices on the matter.

The project has benefited from the assistance received from the project technical anchor (Mr. Javier de la Cruz, former Bank of Spain regulator and supervisor) and project peer reviewer (Mr. Luca Giannini, IFRS expert, Italian Banking Association). Several discussions have been held with the TAN, who actively supported the project working group in finalizing the proposed general principles for the new regulation.

The present document outlines the proposed general principles for the new NBR provisioning regulation, which reflect the consensus of the project working group members from NBR, banks, and MEF. The document also includes an action plan for finalizing the proposed regulation and outlines the steps needed for enabling MEF to make a decision with respect to the fiscal treatment that will be applied to loan loss provisions after the new NBR regulation is enacted.

[1] The workshop on the "International Experience with Provisioning in View of IFRS and Basel II Implementation" was held on April 11, 2007, at the Romanian Banking Institute and gathered more than seventy participants from commercial banks, the National Bank of Romania, the Ministry of Public Finance, etc.

I. The general principles for the new IFRS provisioning regulations

NBR considers that the starting point of the reform of the provisioning regulations must be a complete adaptation to international standards that are represented in the accounting context by IFRS, as they are universally accepted, including by the Basel Committee on Banking Supervision. This approach will ensure that banks' assets are reflected at their true and fair value and that the provisions calculated represent an adequate measure of credit risk.

As such, only minor and punctual adjustments based on prudential considerations or supplemental clarifications, where it will be deemed necessary, will be added in the new provisioning regulations. The public-private project working group (PWG) outlined the following principles for the new IFRS provisioning regulations (see Appendix 3, page 14) for a detailed presentation of the principles):

Principle 1. "The provisioning regulatory framework reform will be fully compliant with international accounting standards (IFRS), so only minor prudential adjustments or supplemental clarifications will be additionally considered".

Principle 2. "The new provisioning regulatory framework will include two streams, namely:
2.1. the "accounting" stream, which will entail the transposition of the IFRS principles pertaining to loan loss provisioning (see Appendix 3, Box 1, page 14);
2.2. the "supervisory and validation" stream, which will provide guidance for the development of banks' IFRS internal models and will outline the principles for the validation of these models" (see Appendix 3, Box 2 and Box 3, pages 16-17).

Principle 3. "Banks will decide whether to develop their own IFRS internal models and submit them for NBR validation; in the meantime they will continue to apply the current provisioning framework, with some amendments (see Appendix 3, Box 4, page 17). Nevertheless, NBR will require the application of the current provisioning regulations to banks until their internal models are recognised and during the transitional period of three years after the IFRS internal models are recognized."

Principle 4. "During the transitional period of three years, when the current provisioning methodology and the IFRS internal models based methodologies will be applied in parallel, the provisions that banks will set up will not be lower than a level determined as a proportion from the needed provisions, calculated according to the current methodology. This proportion will be gradually reduced over the transitional period".

Principle 5. "NBR would like to consider expected losses (in line with Basel II requirements) as well as incurred losses (based on IFRS), so it is analysing the way statistical or dynamic provisions could be introduced in Romania. The new provisioning regulations will be therefore compatible with the implementation of statistical/dynamic provisioning at a further stage" (see Appendix 3, Box 5, page 18).

Principle 6. "Ministry of Economy and Finance will consider the tax deductibility of the provisions resulting from the reform under the following considerations:
a) technical adequacy and robustness of the projected regulatory framework;
b) budget considerations" (see Appendix 3, Box 6, page 18).

Besides the above mentioned principles, the NBR is considering implementing the following rules:

> ***Applicability of the new provisioning regulation*** - the new provisioning regulations will be applied to credit institutions, Romanian legal entities;
>
> ***Scope of the new provisioning regulation*** **–** the new provisioning regulation will include in the base of calculation of provisions both on-balance sheet and off-balance sheet items, provided that they bear a credit risk. The balances from nostro and vostro accounts will be excluded from the base of calculation of provisions.

II. Main benefits and costs of the new IFRS provisioning regulations for the stakeholders

The new IFRS provisioning regulations will have the following benefits and costs for the stakeholders (see Appendix 6 for a comparison between the current and the proposed provisioning regulations):

Table 1. The main benefits and costs of the new IFRS provisioning regulations

Stakeholder	Main benefits of the new regulation	Main costs of the new regulation
NBR	- a modern provisioning regulatory framework, aligned with international standards (IFRS), with an increased degree of sensitivity to credit risk and having a forward-looking perspective (as it could allow the future implementation of dynamic provisioning).	- allow for more banks' "discretion" in establishing the level of provisions; - an additional burden for the Supervision Department, which will have to validate the IFRS internal models of banks.
Banks	- increase the degree of sensitivity to risk of the provisioning framework; - remove the dual system of calculating provisions based on RAS for prudential and fiscal purposes and based on IFRS for reporting to mother entities and ensure a consolidated approach among the NBR, auditors and possibly MEF; - P/L impact to be further determined.	- banks will have to develop IFRS internal models and to have them validated by NBR and possibly by external auditors; - P/L impact to be further determined.
MEF	- a regulatory framework for provisioning aligned with international accounting standards (IFRS); - fiscal impact to be further determined.	- a lesser degree of "control" over the calculation of provisions and more reliability on NBR validation if internal models will be accepted for the determination of provisions for fiscal purposes; - fiscal impact to be further determined.

III. Implementation action plan

On the basis of the information available in July 2007, the SPI Secretariat believes that the following implementation action plan is feasible. The action plan targets the achievement of the following by the end of 2007:

1. the amendment of the current provisioning regulations;
2. the enactment of the new NBR IFRS provisioning regulations;
3. a MEF decision on the fiscal treatment of IFRS provisioning;
4. an NBR Board resolution on a timeline for implementing the statistical provisioning.

Objective	Actions	Responsible	Timeline
Amendment of current NBR provisioning regulations (Regulation no. 5/2002)	Modification of current provisioning rules for IFRS transitioning as shown in Box 4 (page 17)	NBR PWG members	September 2007
Enactment of new NBR provisioning regulations	Draft accounting stream	NBR (accounting) PWG members	August 2007
	Draft supervisory and validation stream	NBR (prudential) PWG members in consultation with banks PWG members, TAN, and auditors	September 2007
	SPI Committee progress review	**PO**	**September 2007**
	Finalize draft regulation and conduct public consultations	PWG	October 2007
	SPI Committee endorsement of draft regulation	**PO**	**October 2007**
	NBR Board approval	PO	November 2007
	Issuance of new provisioning regulations	NBR	December 2007
MEF Decision on the fiscal treatment	Finalize impact assessment	RIA working group	August 2007
	SPI Committee discussion	**SPI Committee**	**September 2007**
	Draft NBR regulation and results of impact assessment presented to MEF	MEF SPI Committee member	October 2007
	MEF decision on fiscal treatment of new regulation	MEF SPI Committee member	November 2007
NBR Board resolution on a timeline for implementing the statistical provisions	Analyze the feasibility of the basic approach and define the information needs and the vehicles and times required for its collection	NBR (Financial Stability) PWG member with TAN support	August - September 2007

	SPI Committee progress review	**PO**	**September 2007**
	Outline a feasible approach for implementation of statistical provisioning and make a decision regarding the relationship between IFRS provisions and statistical provisions and prepare a note for NBR Board discussions	NBR Financial Stability Department with support from Regulation Department	October 2007
	SPI Committee endorsement of proposed approach	**PO**	**October 2007**
	NBR Board resolution on a decision to implement statistical provisioning	PO	November 2007

<u>Implementation Risks</u>

The main implementation risks lay in a possible delay in the MEF decision on the fiscal treatment applied to provisions following the entry into force of the new prudential framework. The delay could be particularly envisaged in a case in which the impact assessment will outline a significant negative impact on the state budget if IFRS provisions are fully accepted for fiscal deductibility. It should be mentioned that a delay in MEF decision could create uncertainty among banks which may delay their decision in developing IFRS internal models.

This risk could be somewhat mitigated if the impact assessment will run parallel fiscal scenarios, so MEF could decide on a compromise solution (i.e. partial deductibility of IFRS provisions or application of a simplified, parallel methodology), acceptable from a fiscal impact point of view. Therefore, it would be important to receive a timely input from MEF on the envisaged fiscal scenarios in order to fully inform the impact assessment exercise.

IV. Proposed SPI Committee Decision

It is proposed that the SPI Committee takes note of the progress achieved so far by the working group in setting the ground for a regulation that will increase the degree of sensitivity to risk of the provisioning framework and ensure a consolidated approach among NBR, auditors and possibly MEF.

Also, it is proposed that the SPI Committee encourages the working group in finalizing the draft regulation and the impact assessment study in order to support MEF in making a timely decision regarding the fiscal treatment applied to provisions once the new regulations enter into force.

V. Options for actions considered and rejected

The project working group had several discussions with the TAN on possible approaches for the new provisioning regulations:

1. **Implementation of a standard ("default") provisioning model** in the new provisioning regulations. TAN suggested the development of a standard provisioning model, in line with the Spanish experience, which would be applicable to those banks unable to submit (or not yet able to submit) their own internal calculation models to be validated by NBR. While TAN has outlined that this approach would be an useful step for the introduction of statistical provisioning as it will provide some important benchmarks, the NBR representatives outlined the following considerations for not endorsing this option:
   a. NBR would like to encourage banks to move as quickly as possible towards the development of internal models;
   b. NBR is in favour of having a simpler provisioning framework, especially taking into consideration that it will allow for a transitional period when the old and the new regulations will be applied in parallel;
   c. the old regulation could be considered a default model, bearing in mind that some additional prudential filters will be set.

2. **Additional prudential filters** to be introduced in the new provisioning regulation. The TAN outlined that although compliance with IFRS must be considered as a desirable objective in itself, further consideration should be given to the fact that IFRS does not take into account specific banking aspects such as financial restructurings and formal non-substantial renewals, interest accrual on defaulted debt, collateral recognition and valuation, personal additional guarantees, loans with some defaulted instalments and loans with insufficient information to be evaluated. In the TAN's opinion, these issues need to be considered, whether it is taking them as the starting point for the reform, introducing them in a stronger form in the framework or via the establishment of prudential filters, as it has been done in other countries.
   NBR outlined the following considerations in respect to introducing additional filters:
   a. some prudential filters will be introduced in the current provisioning regulation, in order to ensure a sounder credit risk management and to provide further incentives for banks to move towards IFRS internal models;
   b. as far as the new provisioning regulation is concerned, NBR's view is that given that it would like to encourage banks to move as quickly as possible to internal models, which ideally should be very much in line with the Basel II IRB approach. In NBR's view, only the IRB application is going to offer clear indications on the "expected loss" and at that point banks will be able to make an accurate determination of the adequacy of provisions from a prudential point of view. Therefore, the contribution of additional prudential filters will be only marginal and only minor and punctual adjustments based on prudential considerations will be added;
   c. the supervisory guidelines and validation procedure and requirements will act as a substitute for prudential filters.

VI. Open issues for project working group consideration

The following issues are going to be further considered by the project working group in order to identify feasible solutions:

1. **Internal models validation process -** *Regarding the elaboration of guidelines and procedures for the recognition of these internal models, NBR has considered two options:*
   a. The establishment of a formal process of recognition, with specific procedures and guidelines and a clear indication of the different steps to be taken, the contents of each phase and an estimate of the timetable;

b. *The recognition of internal models as part of the supervision process, where regulations and guidelines would be issued in advance, so banks could develop their models according to them and, once implemented, are later supervised by NBR as part of the normal process.*

While a formal recognition process would be universally considered as a more rigorous and robust solution, especially by third parties (including MEF, which need to be comfortable with the validation process in order to endorse the NBR methodology for fiscal purposes), the drawback of this option is that it can imply significant review and validation efforts in a relatively short period of time and therefore an analysis should be made of its practical feasibility before adopting it.

The second choice could be also further discussed in the project working group because if banks could provide satisfactory evidence that their internal models have already been validated by the home supervisor, NBR could also consider this option.

2. **Bank auditors' involvement –** *The NBR would like to determine the degree of involvement of the banks' auditors in the process of validating the IFRS internal models of banks as the NBR would like to make sure that there is a great level of confidence with the internal models of banks.*

While the NBR considers that the primary responsibility of ensuring compliance of internal models with IFRS principles and supervisory guidelines will belong to banks, a closer involvement of auditors will act as an additional check for the supervisory authority. It should be stressed that a closer auditors' involvement may involve additional costs from the banks' point of view and also an additional burden on auditors, things that should be clarified with the two stakeholders. One alternative proposed would be to make a recommendation for having audited the IFRS internal models that will not use parameterized (PD, LGD, etc.) models.

3. The minimum requirements for the IFRS models – *While the NBR would like to encourage banks to use IRB-type (parameterized) models, in practice banks may employ simpler models which are IFRS compliant. Therefore, consideration should be given to achieving a balance between the objectives of NBR and the banks' practices.*

Given the wide variety of IFRS models used by banks, the minimum requirements for IFRS models will have to be designed in a flexible way, so as to allow for the recognition of a broad category of models. Also, the NBR may wish to consider implementing some "positive incentives" for banks to develop IRB-type models, for example by issuing relevant supplementary supervisory guidance.

Appendix 1

Summary of actions undertaken by the project working group

Since the launch of the project, the PWG has undertaken the following actions, aimed at identifying the feasible solutions for the new provisioning regulations:

1. Gathering relevant international experience

The PWG members have gathered relevant international experience on provisioning in view of IFRS and Basel II implementation from mother entities (see Appendix B). Likewise, the SPI Secretariat prepared a document outlining the ECB and Basel Committee on Banking Supervision guidelines and the similarities and difference between IFRS and Basel II approaches. At its February 20th meeting, the PWG outlined that it would like to deepen its understanding of relevant international experience in order to start updating the prudential principles for provisioning.

Therefore, the NBR, the RBA and Convergence, with the support of the SPI Secretariat, jointly organized a workshop aimed at helping local stakeholders and, in particular, the SPI project working group, deepen their understanding of both international supervisory practices and market solutions for provisioning in view of IFRS and Basel II implementation[2].

Also, with the support of Convergence, a TAN (former Bank of Spain regulator and supervisor) and a PR (senior IFRS expert from the Italian Banking Association) with extensive experience on the matter were mobilized to outline international relevant experience and to support the project in agreeing on a set of principles that meet supervisory objectives and reflect IFRS and Basel II standards.

2. Identifying a model that could be further adapted to the Romanian context

Following the workshop on the International Experience with Provisioning in View of IFRS and Basel II Implementation and the discussions held with the TAN and PR, the NBR assessed that the Spanish provisioning model would be an approach that could be further explored.

In this regard, the NBR's view was that the IFRS-based provisions, which cover only for the incurred losses, are not satisfactory from a prudential point of view. Therefore, the NBR outlined that it would like to design a regulation that, similarly to the Spanish experience (see Appendix B), would require banks to calculate provisions that would embed:

a) specific provisions (IFRS based and therefore covering for incurred loss) and
b) statistical/dynamic provisions (to cover for expected losses and estimated on the basis of statistical analysis of similar portfolios).

[2] Among the speakers at the workshop were: Javier de la Cruz (Independent Advisor, former Bank of Spain Regulator and Supervisor), Luca Giannini (Senior IFRS Expert, Italian Banking Association), Adam Kolaczyk (Director, Deloitte, Poland), Alexander Beck (Manager, Bearing Point, Germany), Angela Manolache (Manager, KPMG, Romania), Andrew Fishman (Managing Director, Algorithmics, UK).

3. Developing a specific approach for the new provisioning regulations

As outlined above, the NBR has developed, starting from the Spanish model, a specific approach for the new provisioning regulations. The approach took into consideration the NBR specific regulatory and supervisory objectives and the market realities. While the above mentioned principles represent the base for the new provisioning regulations, the regulations will be drafted in close consultation with the market participants. In particular, the supervisory and validation streams of the new regulations will be developed with further input from banks and other stakeholders (e.g. auditors).

Appendix 2

Summary of Regulatory Impact Assessment (RIA) actions implemented

I. Preliminary RIA

A preliminary RIA performed by Convergence made a rough estimate of the savings that banks will have from eliminating the double reporting of provisions (according to RAS for prudential and fiscal purposes and according to IFRS for reporting to mother entities). The findings of the preliminary RIA show that banks could save RON 177 mil. (5 year net present value) from the elimination of double reporting.

II. Bank survey

A basic bank survey has been conducted by the SPI Secretariat in May 2007 on the level of provisions based on RAS on the one hand and IFRS on the other hand. The survey outlined that there are differences between the RAS and IFRS provisions running in both ways (e.g. in some cases, the RAS provisions are bigger that the IFRS ones, while in other cases, the IFRS provisions are bigger than the RAS ones).

From discussions had with the banks' representatives in the PWG, it resulted that differences between the levels of provisions based on the two standards may depend on:

- whether some banks have decided to adopt more conservative approaches in the application of contagion effects in the collective assessments of impairment (some banks have used for this purpose the definition for large exposure);
- the way in which collateral has been considered (according to RAS collateral is considered at its market value, while IFRS looks both at the estimated future cash flows from the collateral discounted at an effective interest rate, based on historical information on recoveries);
- the proxies that each IFRS model uses in lack of available data on losses and recoveries;
- the way in which banks have defined the indications for impairment;
- the quality and the structure (retail / corporate) of each bank's credit portfolio.

The PWG acknowledged that it would be very important to understand where the RAS-IFRS differences stem from and outlined the importance of performing a comprehensive impact assessment, which would be useful both for banks and for MEF, in order to make a decision regarding the tax treatment of provisions after the new provisioning framework will enter into force.

III. Full impact assessment

The PWG agreed to set up a separate group (RIA working group) to perform a full impact assessment on the effects of the new regulatory framework on bank provisioning and on the state budget. The impact assessment will support the Ministry of Economy and Finance in making a decision with regard to the fiscal treatment that will be applied to banks' provisions following the application of the new regulatory framework.

The RIA working group will be composed of banks, NBR, MEF, Convergence and SPI and will define the methodological approach and the data needs, will provide indications on data compilation and will validate the RIA findings. The following action plan will be followed by the impact assessment working group:

Table 1. Impact Assessment Action Plan

	Action	Initiation date	Completion date	Responsibility
I	**Set up PWG** - prepare invitation letters for banks and MEF - get confirmations	July 5	July 10	SPI Secretariat
II	**Establish the IA approach** - outline methodology used - define data needs, data sources and ways of compiling the data	July 11 (PWG meeting)	July 13 (PWG endorsement on final document)	PWG
III	**Prepare the IA questionnaire**	July 17 (draft questionnaire prepared)	July 19 (PWG endorsement)	Convergence / SPI with input from PWG
IV	**Run the survey**	July 20 (survey sent through RBA)	July 31 (deadline for submissions)	SPI Secretariat
V	**Receipt of fiscal scenarios from MEF**	July 25 (SPI SC Meeting)		MEF / SPI Secretariat
VI	**Compile the survey data**	August 1	August 8	SPI Secretariat
VII	**Draw preliminary findings**	August 9	August 16	Convergence / SPI
VIII	**Share preliminary findings with PWG**	August 16	-	Convergence / SPI
IX	**PWG feedback on preliminary findings**	-	August 23	PWG
X	**Validation of IA findings**	August 27 (PWG meeting)	-	PWG
XI	**Prepare IA Paper**	August 27	August 31	Convergence / SPI
XII	**Results sharing with decision makers**	September 3	-	SPI
XIII	**SPI Committee Discussion**		September 30	SPI

Also, a letter has been addressed to MEF, requiring it to outline the possible fiscal scenarios envisaged (e.g. full fiscal deductibility of IFRS provisions, partial deductibility of IFRS provisions, other methodologies to be applied in order to calculate provisions for fiscal purposes, etc.) by July 25, in order to enable a more accurate determination of the impact of the new provisioning regulations on banks and on the general budget.

So far, the RIA working group has defined the impact assessment methodology and data needs and launched the comprehensive bank survey based on the questionnaire prepared by Convergence and the SPI Secretariat.

Appendix 3

Detailed Principles of the New IFRS Provisioning Framework

Principle 1. "The provisioning regulatory framework reform will be fully compliant with international accounting standards (IFRS), so only minor prudential adjustments or supplemental clarifications will be additionally considered".

Principle 2. "The new provisioning regulatory framework will include two streams, namely:

2.1. the accounting stream, which will entail the transposition of the IFRS principles pertaining to loan loss provisioning (see Box 1);

Box 1. Accounting stream of the new NBR provisioning regulations

2.1.1. Recognition of impairment loss

A financial asset or group of assets is impaired, and impairment losses are recognized, only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Losses expected as a result of future events, no matter how likely, are not recognized. [IAS 39.59]

An entity is required to assess at each balance sheet date whether there is any objective evidence of impairment. [IAS 39.58] If any such evidence exists, the entity is required to do a detailed impairment calculation to determine whether an impairment loss should be recognized.

IAS 39 provides a list of loss events, but do not limit the objective evidence of impairment only to data about these events. The examples of loss events provided are the following:
- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group. [IAS 39.59]

In some cases the observable data required to estimate the amount of an impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances. In such cases, an entity uses its experienced judgment to estimate the amount of any impairment loss. [IAS 39.62]

2.1.2. Assessment of impairment loss

An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment. [IAS 39.64]

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms (for example, on the basis of a credit risk evaluation or grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). If an entity does not have a group of assets with similar risk characteristics, it does not make the additional assessment. [IAS 39 AG87]

Impairment losses recognized on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group. [IAS 39 AG88]

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Entities that have no entity-specific loss experience or insufficient experience use peer group experience for comparable groups of financial assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. [IAS39 AG89]

2.1.3. Measurement of impairment loss

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in profit or loss. [IAS 39.63]

Effective interest rate and the effective interest rate method
The *effective interest method* is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.
The *effective interest rate* is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but shall not consider future credit losses.
The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. [IAS 39.9]

Collateralized financial asset

The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. [IAS39. AG 84]

Subsequent reversal of provisions
If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal shall be recognized in profit or loss. [IAS 39.65]

2.1.4. Interest income after impairment recognition

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. [IAS39 AG93]

2.2. the supervisory and validation stream, which will provide guidance for the development of banks' IFRS internal models and will outline the principles for the validation of the banks' internal IFRS models" (see Box 2 and Box 2);

Box 2. Supervisory guidance of the new NBR provisioning regulations

The application of the supervisory guidelines will be done in such a way that does not preclude or impede in any sense a proper implementation of IFRS, but, on the contrary, contribute effectively to this purpose in a consistent and coherent manner.

2.2.1. A bank's board of directors and senior management are responsible for ensuring that the bank has appropriate credit risk assessment processes and effective internal controls commensurate with the size, nature and complexity of its lending operations to consistently determine provisions for loan losses in accordance with the bank's stated policies and procedures, the applicable accounting framework and supervisory guidance;

2.2.2. A bank should have a system in place to reliably classify loans on the basis of credit risk;

2.2.3. A bank's policies should appropriately address validation of any internal credit risk assessment models;

2.2.4. A bank should adopt and document a sound loan loss methodology, which addresses credit risk assessment policies, procedures and controls for assessing credit risk, identifying problem loans and determining loan loss provisions in a timely manner;

2.2.5. A bank's aggregate amount of individual and collectively assessed loan loss provisions should be adequate to absorb estimated credit losses in the loan portfolio;

2.2.6. A bank's use of experienced credit judgment and reasonable estimates are an essential part of the recognition and measurement of loan losses;

2.2.7. A bank's credit risk assessment process for loans should provide the bank with the necessary tools, procedures and observable data to use for assessing credit risk, accounting for loan impairment and determining regulatory capital requirements.

Box 3. Validation guidance of the new NBR provisioning regulations

2.2.8. The internal models of the credit institutions will undergo a validation process, which will entail requirements similar to those set up in the New Capital Accord for the internal rating based approach (IRB), but with a lesser degree of complexity.

2.2.9. In addition, the final validation stream shall take into account provisions from other relevant documents issued by Basel Committee, as follows:

- Basel Committee Newsletter No. 4 (January 2005) "Update on work of the Accord Implementation Group related to validation under the Basel II Framework";
- Basel Committee Newsletter No. 6 (September 2005) "Validation of low-default portfolios in the Basel II Framework".

Principle 3. "Banks will decide whether to develop their own IFRS internal models and submit them for NBR validation or to continue to apply the current provisioning framework, with some amendments (see Box 4). Nevertheless, NBR will require the application of the current provisioning regulations to banks until their internal models are recognised and during the transitional period of three years after the IFRS internal models are recognized."

Box 4. Amendments that will be brought to the current provisioning regulations

NBR will make the following adjustments to the current regulation, aimed at ensuring a prudent evaluation of provisions and providing more incentive to banks to move towards developing their own IFRS internal models:

3.1. Establish eligibility criteria for collateral: only marketable and liquid collateral will be considered for provisioning purposes;
3.2. Treatment of exposures fully backed by cash collateral: operations that are fully collateralized with cash deposits will not longer included in the basis for calculating the provisions;
3.3. Application of risk mitigation techniques to collateral: the regulation will apply the risk mitigation techniques specific to Basel II;
3.4. Treatment of retail portfolio: further classifications of the retail exposures will be only based on the debt service (no longer based on both creditworthiness and debt service).

Principle 4. "During the transitional period of three years, when the current provisioning methodology and the IFRS internal models based methodologies will be applied in parallel, the provisions that banks will set up will not be lower than a level determined as a proportion from the needed provisions, calculated according to the current methodology. This proportion will be gradually reduced over the transitional period".

Principle 5. "NBR would like to consider expected losses (in line with Basel II requirements) as well as incurred losses (based on IFRS), so it is analysing the way statistical or dynamic provisions could be introduced in Romania. The new provisioning regulations will be therefore compatible with the implementation of statistical/dynamic provisioning at a further stage" (see Box 5).

Box 5. Considerations on the implementation of statistical/dynamic provisioning in Romania

NBR is considering the way in which statistical (dynamic) provisions could be introduced in Romania, so expected losses could also be considered in terms of the required provisions. Also, the statistical/dynamic provisions would have an anti-cyclical effect, in line with the ECB recommendation (see Appendix A) that provisioning regulations should encourage the use of methods that aim at identifying credit losses already inherent in a particular credit portfolio at the present time.

As such, NBR contemplates a double approach:
a) A basic approach, based on limited historic data and estimates that could be introduced in the short term;
b) A more complete or advanced approach, based on more specific and complete data that could be implemented in the mid term.

NBR is currently analysing the feasibility of the basic approach, taking into account the available data. Banks collaboration in this regard would be welcome, especially in terms of providing their internal relevant data.

At the same time, NBR will be evaluating the information needs for a more complete and advanced approach, so as to define and establish an information regime that could allow to collect the required data from the near future on and, consequently, to implement this approach in the mid term.

Regarding the relationship between expected losses provisions (statistical) and incurred losses provisions (IFRS based) NBR is analysing the way they should interact and evaluating the following options:

1) specific provisions and statistical provisions should be added;
2) specific provisions should be deducted from statistical provisions;
3) the biggest amount between specific and statistical provisions will be required.

Although no decision has already been made, NBR currently considers that the second option is the best one from a technical point of view.

Principle 6. "Ministry of Economy and Finance will consider the tax deductibility of the provisions resulting from the reform under the following considerations:

c) technical adequacy and robustness of the projected regulatory framework;

d) budget considerations" (see Box 6).

Box 6. Tax considerations on the implementation of the new provisioning framework in Romania

Based on discussions held with MEF on July 3, 2007, it resulted that MEF would only accept the provisions resulting from the new framework if it is convinced that the scheme is technically adequate and if it is going to be applied on a consistent and rigorous base.

MEF could also consider if it would be preferable to have tax haircuts or limits to tax deductions, instead of different methodologies. More specifically, haircuts could consist in maximum percentages of provisions to be deducted and limits to tax deductions could be formulated in terms of a maximum percentage of the loan portfolio.

In order to support MEF's decision, a project working group has been set up to perform a comprehensive impact assessment (see section IV on the RIA actions undertaken so far). The impact assessment will be based on the tax treatment scenarios that will be provided by MEF.

Appendix 4

The international experience with IFRS provisioning

The project working group (PWG) has discussed about the international experience on loan loss provisioning from the perspective of IFRS implementation, as gathered by the PWG members and the SPI Secretariat.

Austrian experience

In Austria, at individual level, banks are applying the Austrian GAAP. Also, the methodology to recognize loan losses and to provision the loan is based on Austrian GAAP for single bank accounts and on IFRS for group financial statements.

Regarding the linkage between Basel II and IFRS application, although the Basel II-definition of default is slightly less comprehensive than the impairment definition under IFRS (IAS 39) and thus a Basel II trigger event can only be an indication for impairment, in almost every cases a Basel II trigger event will lead to impairment under IFRS.

The LGD is used as a test for the adequacy of provisions’ level and the change between different internal rating classes (“migration PDs”) as basis for provisioning at portfolio level.

It was outlined the importance of having stable data series, covering at least some years. From this point of view, the databases that are set up for Basel II purposes by banks in Romania will need a couple of years of data gathering in order to become fully operational.

Also, in Austria, the size of the provisions is based on the banks’ individual judgment; however, the use of sound and prudent credit risk assessment is checked by the banks’ auditors and reported to the supervisory authority by them.

Italian experience

The Italian experience was discussed based on the document provided by the project technical anchor from the Italian Banking Association.

Italian banks apply IAS/IFRS at individual bank level. The supervisory rules are drawn from Basel II provisions. Banks disclose in the notes to the financial statements the methodology used for the loan loss provisioning, and the extent to which it differs from Basel II rules.

For fiscal purposes, a separate methodology is applied. Namely, banks and other financial institutions are allowed to include the total amount of the impairment losses registered in the financial statements but the amount of impairment losses exceeding 0.4% of the credits is to be carried over in nine yearly instalments.

If in a year, the total amount of impairment losses on customer loans is below the 0.4% threshold, only for fiscal purposes, allocations to "portfolio allowances" may also be deducted to bring the total deduction to the 0.4% figure. Allocations are no longer deductible when their total amount exceeds 5% of the value of balance-sheet loan assets at the end of the year.

Spanish experience

The NBR managed to gather additional information on the Spanish system of provisioning, which for the time being seem to be the most advanced country in developing a provisioning methodology that is in line with IFRS and Basel II requirements.

In Spain, data in the Central Credit Register (CCR), which cover virtually the last twenty years, have been used to construct a set of matrices of specific provisions to cover losses incurred and individually identified, distinguishing between companies and sole proprietors, on the one hand, and other individuals, on the other.

As regards general provisions, the losses inherent in loan portfolios classified as normal risk must be covered in accordance with the historical experience of impairment and other circumstances known at the time of assessment. The use of the CCR has enabled a parametric method to be developed, based on statistical procedures, for the calculation of the coverage of losses that have been incurred but not individually identified. The accounting standard establishes the possibility that institutions may use internal models to calculate their bad debt provisions.

Greek experience

In Greece, IFRS is not yet applied at individual banks' level. However, there are indications that Greece is also considering the modification of the prudential rules in view of IFRS application. More information will be made available as soon as the mother banks and possibly the Hellenic Banking Association will send their feedback on the issues raised in the PWG.

United States

According to the US GAAP rules on loan-loss allowances, *no impairment loss should be accrued unless the impairment* (i.e. the probability, on the date of the financial statements, that the creditor will be unable to collect all amounts due according to the contractual terms) *can be attributed to events or activities of the current or prior periods, and no anticipated losses that do not relate to the current period should be accrued.* These provisions, which are very similar to those of the IFRSs, can be, and have been, interpreted in various ways.

While requiring that the financial institutions' methodologies be consistent with the US GAAP, the US banking supervisory agencies, in collaboration with the SEC, have developed joint guidance in which they recommend that the institutions estimate collective impairment for groups of loans by applying to loan balances loss rates that reflect their historical charge-off experience adjusted for the effects of current conditions. This guidance also allows the overall allowances to include "unallocated" components, as long as these components reflect an adequately documented estimate of probable losses, and recognizes that determining an appropriate allowance involves a high degree of managerial judgment. A similar approach could be conceivable under the IFRSs.

Appendix 5

The international guidelines for provisioning

European Central Bank Guidelines

In a recent report on "Assessment of Accounting Standards from a Financial Stability Perspective" (December 2006), the ECB outlined that "***the implementation of standards on provisioning should not be conducive to increased pro-cyclicality, but should rather encourage the use of methods that aim at identifying credit losses already inherent in a particular credit portfolio at the present time***".

Where provisioning is concerned, ECB considers that accounting should ideally incorporate a pro-active approach that is comparable to sound credit risk management, which tries to identify expected collective losses as soon as possible, in particular those that may be embedded in loans and relate to sectoral, geographical or even global monetary and other economic developments, be they existing or anticipated.

Otherwise, banks may persist in pursuing very dynamic lending strategies or practices, and thus potentially continue to accumulate significant future loan losses. If, during economic upturns, the accounting framework is not sufficiently flexible to allow the recognition in the accounting of the increasing credit risk that banks incorporate in their loan portfolios, the impact would be much greater in phases of downturn, since large amounts of losses would suddenly have to be recognized. Therefore, an accounting regime that does not allow forward-looking provisioning may deepen crises and have a pro-cyclical effect.

As for the promotion of forward looking recognition of risks, the ECB indicates that an approach to promoting forward-looking provisioning could entail adjusting the value of the banking book in the form of ***dynamic provisioning***. Dynamic provisioning recognizes that:

(i) a certain fraction of a currently unimpaired portfolio can be expected to deteriorate in the future and that

(ii) the magnitude of these "expected-but-not-materialized" losses over the lifetime of the portfolio can be predicted on the basis of statistical analysis of similar portfolios.

As a result, dynamic provisioning prevents latent credit losses from remaining hidden, since the losses are recognized before the signs of deterioration become evident.

Basel Committee on Banking Supervision Guidelines

The Basel Committee on Banking Supervision (BCBS) report entitled "Sound Credit Risk Assessment and Valuation for Loans" (November 2005) promotes the use by banks of sound and prudent credit risk assessment and valuation policies and practices.

BCBS considers that ***the processes for estimating probability of default and expected losses under Basel II can be used in measuring impairment losses for accounting purposes***. Indeed, it seems advisable that the credit risk assessment system used for accounting purposes and the prudential expected-loss approach under Basel II be better aligned, while at the same time expanding the loan-loss provisioning method beyond the one-year time horizon, in order to wholly capture the maturity of loans and related risks.

Appendix 6

A comparison between the current and proposed provisioning regulations

New regulation principles	Current regulation principles (NBR Regulation no.5/2002 and Norms no.12/2002, with further amendments)	Differences between the current and the proposed provisioning regulations
Accounting stream (implementation of IAS 39 provisions on impairment of financial assets)		
<u>I. Recognition of impairment loss</u> A financial asset or group of assets is impaired, and impairment losses are recognized, only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Losses expected as a result of future events, no matter how likely, are not recognized. [IAS 39.59] An entity is required to assess at each balance sheet date whether there is any objective evidence of impairment. [IAS 39.58] If any	Loan loss provisions are calculated on the basis of a provisioning matrix that specifies fixed provisioning rates for 5 categories of loans, depending on a) the number of days of overdue payment, b) the debtor financial performance and c) whether legal procedures were initiated against the debtor. The debtor financial performance is assessed according to internally established rules approved by the credit institution Board of Directors and by the NBR. These internal rules provide quantitative (liquidity, solvability, profitability and risk ratios) and qualitative (management and shareholders characteristics, market conditions, guarantees - other than those that are accepted to be	Under IAS 39 loan impairment losses are recognized only if there is <u>objective evidence</u> of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the loan (or group of loans) that can be reliably estimated, this process being very much based on professional judgment, whereas current NBR regulations, by using a provision matrix, take into account as evidences of impairment only 3 factors, respectively the number of days of overdue payment, the debtor financial performance and

such evidence exists, the entity is required to do a detailed impairment calculation to determine whether an impairment loss should be recognized. IAS 39 provides a list of loss events, but do not limit the objective evidence of impairment only to data about these events. The examples of loss events provided are the following: - significant financial difficulty of the issuer or obligor; - a breach of contract, such as a default or delinquency in interest or principal payments; - the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider; - it becoming probable that the borrower will enter bankruptcy or other financial reorganization; - the disappearance of an active market for that financial asset because of financial difficulties; or - observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group. [IAS 39.59] In some cases the observable data required to	deducted from the exposure) criteria which help identify the appropriate category of financial performance for each debtor. Using a provision matrix the current regulations are more rigid than IAS 39 provisions on loan loss provisioning, which are very much based on professional judgment when determining the objective evidence of impairment.	whether legal procedures were initiated against the debtor.

estimate the amount of an impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances. In such cases, an entity uses its experienced judgment to estimate the amount of any impairment loss. [IAS 39.62]		
II. Assessment of impairment loss An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment. [IAS 39.64] For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms (for example, on the basis of a credit risk evaluation or grading process	The assessment of loans impairment is made only individually.	Under IAS 39 assessment of loans impairment is performed both individually and collectively whereas in accordance with the NBR regulations it is made only individually.

that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). If an entity does not have a group of assets with similar risk characteristics, it does not make the additional assessment. [IAS 39 AG87] Impairment losses recognized on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group. [IAS 39 AG88] Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Entities that have no entity-specific loss experience or insufficient experience use peer group experience for comparable groups of financial assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows		

reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. [IAS39 AG89]		
III. Measurement of impairment loss The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in profit or loss. [IAS 39.63]	The amount of the loss is determined by applying the provision rate provided for each loan category to the exposure value diminished with the fair value of the eligible collateral if the loan is not put in the “loss” category; if the loan is categorized as “loss”, generally the collateral is not taken into account (the collateral may be considered only if the loan is categorized as “loss” due to the financial performance of the debtor). The carrying amount of the asset is reduced through use of an allowance account and the amount of the loss is recognized in profit or loss. Furthermore, the loans granted to one debtor must be classified in the same category (the category of the lowest classified loan),	Under IAS 39 the amount of the loss is measured as the difference between the loan carrying amount and the present value of estimated cash flows discounted at the effective interest rate computed at initial recognition of the loan, whereas in accordance to the NBR regulations the amount of the loss is determined by applying the provision rate provided by the matrix for each loan category to the exposure value diminished with the fair value of the eligible collateral if the loan is not put in the “loss” category. If the loan is categorized as “loss”, generally the collateral is not taken into account when measuring the impairment loss (the collateral may be considered only if the

	irrespective of their individual classification - the “tainting”/”contagion” rule.	loan is categorized as “loss” due to the financial performance of the debtor). IAS 39 does not provide any “tainting” rule of the loans granted to one debtor while the NBR rules include such a provision.
Effective interest rate and the effective interest rate method The *effective interest method* is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The *effective interest rate* is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but shall not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. [IAS 39.9]	The effective interest rate method is not required by the regulations, but according to the accounting regulations into force credit institutions may apply this method to recognize the deferred costs and commissions received associated with the loan or may linearly spread these amounts over the period till maturity.	IAS 39 provide that loans are measured at amortized cost using the effective interest rate method, while according to the NBR prudential and accounting regulations this method is not compulsory.

Collateralized financial asset The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. [IAS39. AG 84]	The fair value of the collateral is taken into account if the loan is not put in the "loss" category (and also, the collateral may be considered if the loan is categorized as "loss" due to the financial performance of the debtor) without considering the time value of money.	As concerns the collateralized loans, under IAS 39 the collateral value less the costs for obtaining and selling it is taken into account as a future cash flow and discounted using the original effective interest rate when calculating the impairment loss, while according to the NBR regulations the fair value of the collateral is taken into account if the loan is not put in the "loss" category (and also, the collateral may be considered if the loan is categorized as "loss" due to the financial performance of the debtor) without considering the time value of money. Some changes will be made to the current regulation to consider only liquid and marketable collateral.
Subsequent reversal of provisions If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized	Provisions are adjusted (increased or decreased) to reflect the current assessment of the credit risk according to the provision matrix.	Both frameworks have similar provisions for recognition in profit or loss the subsequent reversal of loan loss provisions.

at the date the impairment is reversed. The amount of the reversal shall be recognized in profit or loss. [IAS 39.65]		
IV. Interest income after impairment recognition Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. [IAS39 AG93]	Interest income after impairment recognition is recognized using the contractual interest rate and a provision is simultaneously recognized the amount of which is determined by the category where the loan is classified.	Under IAS 39 interest income after impairment recognition is recognized using the original effective interest rate used to discount the future cash flows for the purpose of measuring the impairment loss, whereas in conformity to the NBR regulations interest income is recognized using the contractual interest rate and a provision is simultaneously recognized.
Supervisory guidance **(implementation of Basel Committee principles for sound credit risk assessment and valuation for loans)**		
A bank's board of directors and senior management are responsible for ensuring that the bank has appropriate credit risk assessment processes and effective internal controls commensurate with the size, nature and complexity of its lending operations to consistently determine provisions for loan losses in accordance with the bank's stated policies and procedures, the applicable accounting framework and supervisory guidance.	No specific requirements to calibrate the credit risk assessment processes and internal controls with the size, nature and complexity of the banks' lending operations. Also, no requirement to consistently determine provisions for loan losses in accordance with the bank's stated policies and procedures.	The new framework will require a more responsible approach of the banks' board of directors and senior management regarding provisioning.
A bank should have a system in place to reliably classify loans on the basis of credit risk.	A system for loans classification on the basis of credit risk should be in place.	No significant change, except for stipulating more explicit requirements (to be further detailed by NBR).
A bank's policies should appropriately address validation of any internal credit risk assessment models.	No requirements.	According to the new regulations, the validation of the internal credit risk assessment models will belong firstly to

		banks. The models will be subsequently validated by auditors and supervisors.
A bank should adopt and document a sound loan loss methodology, which addresses credit risk assessment policies, procedures and controls for assessing credit risk, identifying problem loans and determining loan loss provisions in a timely manner.	Banks should have internal norms for loan loss methodologies.	No significant changes, except for stipulating more explicit requirements (to be further detailed by NBR).
A bank's aggregate amount of individual and collectively assessed loan loss provisions should be adequate to absorb estimated credit losses in the loan portfolio.	Banks make only individual assessments of loan loss provisions.	The new regulations will imply that banks will make both individual and collective assessments of loan loss provisions.
A bank's use of experienced credit judgment and reasonable estimates are an essential part of the recognition and measurement of loan losses.	The criteria for recognition and measurement of loan losses are set up by NBR.	The new regulations will imply more flexibility on the banks' side in recognizing and measuring the loan losses.
A bank's credit risk assessment process for loans should provide the bank with the necessary tools, procedures and observable data to use for assessing credit risk, accounting for loan impairment and determining regulatory capital requirements.	No specific requirements are provided.	The new regulations will stipulate more specific requirements (to be further detailed by NBR).
Validation guidance (requirements and procedures for validation of IFRS internal models)		
Quantitative and qualitative requirements for validation of IFRS internal models.	Banks' internal norms for assessing debtors' financial performance are approved by the board of directors and NBR.	NBR Supervision Department will validate the banks' IFRS internal models, according to a procedure to be established (a possible approach would be to impose more qualitative requirements).