Dynamic Provisioning

April 2012
**Agenda**

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What is dynamic provisioning?
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A closer look at dynamic provisioning
Difference between collective impairment and dynamic provisioning
Criticism of dynamic provisioning
Spain ... A live situation
Criticism of current model under IAS 39
‘Expected loss’ model proposed by IFRS 9 (ED)
What are others saying on dynamic provisioning?
Concluding remarks
Introduction
Why is the financial system so procyclical?

The current financial crisis is a clear, though painful, example of excess pro-cyclicality in the banking industry. This is due to a number of reasons including:

- the financial system is prone to have a more lax assessment of risk in good times than in bad ones influenced by the economy’s general environment
- borrowers’ net worth is higher during upturns, facilitating their access to credit
- competition within the financial services sector
- principal-agent issues such as conflicts of interest
Introduction
Birth of dynamic provisioning

Procyclicality cannot be eliminated but only mitigated. Provisions and capital are two typical tools used to mitigate procyclicality.

Banco de España, Spain’s central bank and its banking supervisor, put dynamic provisions into place in July 2000, to cope with a sharp increase in credit risk on Spanish banks’ statements of financial position following a period of significant credit growth.

Other countries that use dynamic provisioning are Peru, Columbia and Uruguay.
What is dynamic provisioning?

Definition

“Dynamic Provisioning is a macro-prudential tool to enhance bank soundness and to help mitigate part of the procyclicality of the banking system”

- Jesús Saurina (Head of Financial Stability Department of the Banco de España)

Dynamic provisioning has been championed by Spanish officials and by banking regulators elsewhere as a counter-cyclical alternative to the status quo. It is a way to ensure that banks aren't hit by rising loss reserves at exactly the same time their lending powers are required in order to help stimulate an ailing economy.
**What is dynamic provisioning?**

Arguments in favour of Dynamic Provisioning

There is a widespread experience among many banking supervisors across the world that banks’ lending mistakes are more prevalent during upturns when both borrowers and lenders are over-confident about investment projects. Over-optimism by banks may lead to lower lending standards.

Moreover, loans granted during boom periods have a higher default rate than those granted during slow credit growth periods. So, those in favour of dynamic provisioning argue that banks recognise the increase in credit risk / credit losses in their loan portfolios at the time that risk is building up.
What is dynamic provisioning?
Arguments in favour of Dynamic Provisioning

Loan loss provisions, an accounting item to cover credit losses, is the natural tool to be used to recognise credit risk and credit losses along the lending cycle. Prudent loan loss provisions enhance the soundness of each bank as well as that of the banking system, and might be utilised in helping to curb procyclicality in lending.

The dynamic provisioning framework recognises that credit risk is incurred during booms when loan portfolios are expanding, such that loan losses are already lurking on the balance sheets of banks, although they have not yet been allocated to a specific loan.
What is dynamic provisioning?
Arguments in favour of Dynamic Provisioning

When the economy is doing well (situation 1), dynamic provisioning will start building up the buffer for the losses uncovered during a recession (situation 2). Profits during a boom are therefore lower when dynamic provisioning is applied in order to reduce the adverse impact of a recession.
What is dynamic provisioning?
Arguments in favour of Dynamic Provisioning

The rationale is that we need to be counter-cyclical

A system of dynamic provisions has to be implemented in an expansionary phase of the economy. Conceptually, because this is when credit risk builds up and, practically, because banks need to build up a buffer to be used when the recession arrives, i.e. when credit losses materialise and a specific provision is required on several loans.

Let’s revisit the current IAS 39 accounting treatment with respect to loan provisioning ...
IAS 39 prescribes an ‘incurred loss’ model for loan impairment

IAS 39 considers a loan impaired if, on the basis of objective evidence, it is partly or wholly uncollectible, so that its carrying amount is greater than its estimated recoverable amount.

Objective evidence in this context includes:
1. significant financial difficulty of the issuer;
2. actual breach of contract; and
3. a high probability of bankruptcy.

Therefore, currently we apply an ‘incurred loss’ model in relation to impairment of loans.
IAS 39 contains specific guidance for assessing and measuring the impairment losses of a group of financial assets that is carried at amortised cost. The assessment process is as follows:

1. Individually assess significant loans for impairment
2. Individually or collectively assess non-significant loans for impairment
3. Collectively (within groups of assets with similar credit risk characteristics) re-assess loans that were assessed for impairment but not found to be impaired
4. Do not re-assess loans for impairment collectively if already found to be impaired on an individual basis.
Accounting for loan impairment - IAS 39
Impairment of loan portfolios - summary

Loans to customers

Is the loan individually material?

YES NO

Individually assess for impairment

Does an impairment indicator exist?

YES NO

IMPAIR Assess for impairment collectively

Either individually OR collectively assess for impairment

Does an impairment indicator exist?

YES NO

IMPAIR Do not IMPAIR
Bank Y issued one loan facility of €150,000 at a fixed interest rate of 10%. The principal is repayable in 5 years time (bullet repayment) whereas interest is payable annually at the end of each year.

Date of loan facility: 1 January 2010

The EIR under the incurred loss model, excluding future losses, is 10%.
## Accounting for loan impairment - IAS 39

Example of specific provision - amortised cost schedule

<table>
<thead>
<tr>
<th>Year</th>
<th>Opening amortised cost</th>
<th>Interest income</th>
<th>Cash inflows</th>
<th>Unadjusted amortised cost at year end</th>
<th>Income for the period</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
<tr>
<td>2011</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
<tr>
<td>2012</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
<tr>
<td>2013</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
<tr>
<td>2014</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
</tbody>
</table>
Accounting for loan impairment - IAS 39
Example of specific provision - background information

- At 31 December 2011, following a review of the client’s financial condition it was determined that the loan is impaired (assume that the client is now experiencing financial difficulty)
- On the basis of the information available at 31 December 2011, the Bank Y’s best estimate of future cash flows (on a yearly basis) is cash receipts of:
  - 31 December 2012 €14,250
  - 31 December 2013 €13,500
  - 31 December 2014 €140,250 (including repayment of principal)

The estimated impairment after discounting the future cash flows amounted to €20,517.
### Accounting for loan impairment - IAS 39

Example of specific provision - impairment

<table>
<thead>
<tr>
<th>Year</th>
<th>Opening amortised cost</th>
<th>Interest income</th>
<th>Cash inflows</th>
<th>Unadjusted amortised cost at year end</th>
<th>Impairment</th>
<th>Income for the period</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td></td>
<td>15,000</td>
<td>10.00%</td>
</tr>
<tr>
<td>2011</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>(20,517)</td>
<td>(5,517)</td>
<td>-3.68%</td>
</tr>
<tr>
<td>2012</td>
<td>129,483</td>
<td>12,948</td>
<td>14,250</td>
<td>128,182</td>
<td>12,948</td>
<td>10.00%</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>128,182</td>
<td>12,818</td>
<td>13,500</td>
<td>127,500</td>
<td>12,818</td>
<td>10.00%</td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>127,500</td>
<td>12,750</td>
<td>12,750</td>
<td>127,500</td>
<td>12,750</td>
<td>10.00%</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>68,517</strong></td>
<td><strong>70,500</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Dynamic provisioning**
IAS 39 allows the use of formula-based approaches or statistical methods to determine impairment losses for a group of financial assets.

In the case of portfolio/collective impairment assessment, IAS 39 requires banks to adjust historical loss experience on the basis of current observable data to reflect the effects of current conditions.

Therefore, the current ‘collective impairment’ is still an ‘incurred’ and not an ‘expected’ loss model. It aims to reflect the loss events that have occurred with respect to individual assets in the group, but have not yet been identified on an individual asset basis.
IAS 39 provides an example of an entity that, on the basis of historical experience, determines that one of the main causes of default on credit card loans is the death of the borrower. The death rate is normally constant from one year to another.

On the basis of the historical death rate, the Bank can assume that a proportion of the borrowers in the group died during that year. This would imply that an impairment loss has occurred on this group of loans, even if, at the year-end, the Bank is not yet aware which specific borrowers have died. It would be appropriate for an impairment loss to be recognised for these ‘incurred but not reported’ (IBNR) losses.

However, it would not be appropriate to recognise an impairment loss for deaths that are expected to occur in a future period, because the necessary loss event (the death of the borrower) has not yet occurred.
A closer look at dynamic provisioning
Composition - specific and general components

When dynamic provisioning was first applied in Spain in 2000, provisions had three components: specific, general and statistical. When Spain adopted IFRS in 2005, the method of provisioning was reformed, although it remained the same in principle. Banco de España integrated the general and statistical provisions into one, thus allowing the following provisions:

The specific provision would be raised in respect of losses that were indentified in relation to specific loans.

The general provision would cover the losses in homogenous loan portfolios that, although not yet individually identified, are calculated using statistical procedures.
A closer look at dynamic provisioning
Specific provision under dynamic provisioning - formula

This component is determined by assessing individual loans for impairment.

In Spain, Banco de España provides accounting guidance on specific provisions. Specific provisions are rules-based, therefore lessening management’s judgement, since these are based on objective features such as the time past-due and loan characteristics.
A closer look at dynamic provisioning
General provision under dynamic provisioning - formula

The formula for the general provisions is as follows:

\[
\text{dot}.\text{gen}_t = \alpha \Delta C_t + \left[ \beta - \frac{\text{dot.espe}_t}{C_t} \right] C_t
\]

\(C_t\) = stock of loans at the end of period \(t\);
\(\Delta C_t\) = its variation from end of period \(t-1\) to end of period \(t\) (positive in a lending expansion, negative in a credit crunch);
\(\alpha\) = the estimated average of credit losses or, in other words, the collective assessment for impairment in a cyclically neutral year for each homogeneous group of risk.
\(\beta\) = the historical average of the specific provisions for each homogeneous loan portfolio.
A closer look at dynamic provisioning
General component of dynamic provisioning - 4 elements

Alpha component (α)

1. Reflects the inherent losses of the loans granted in the period
   Worked out as follows: Multiply a certain parameter (α) with the change in the amount of loans granted

Beta component (β)

2. Reflects the average specific provision over a business cycle
   Worked out as follows: Compare parameter (β) with the specific net provision ratio and then multiply the difference with the stock of loans
A closer look at dynamic provisioning
General component of dynamic provisioning - 4 elements

Specific net provisions (dot.espe)

Limit to the general provision

This component is the actual specific net provisions made in the period

This component is used to compare to Beta

This is the maximum amount for the fund of general loan loss provisions fixed at 125% of the product of the parameter α and the total volume of credit exposures.
A closer look at dynamic provisioning
Variable settings

Parameters \( \alpha \) and \( \beta \) were set by Banco de España. Both parameters are the same for all banks. These parameters are based on extensive research and statistics on historical loan loss experience for bank loan portfolios in Spain.

However, an own internal model is allowed, if it meets certain criteria and approved by the banking supervisor.

There are six risk buckets or homogenous groups of risk. Each group has a specific \( \alpha \) and \( \beta \).
# A closer look at dynamic provisioning

## Six risk buckets

<table>
<thead>
<tr>
<th>Risk</th>
<th>Type of loan</th>
<th>Alpha</th>
<th>Beta</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negligible</td>
<td>Cash, public sector and interbank exposures</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Low</td>
<td>Mortgages with an LTV below 80%/ corporations (‘A’ rated or better)</td>
<td>0.6%</td>
<td>0.11%</td>
</tr>
<tr>
<td>Medium-low</td>
<td>Remaining mortgages and other collateralised loans</td>
<td>1.5%</td>
<td>0.44%</td>
</tr>
<tr>
<td>Medium</td>
<td>Other loans including corporations with a credit rating of less than A, or unrated</td>
<td>1.8%</td>
<td>0.65%</td>
</tr>
<tr>
<td>Medium-high</td>
<td>Consumer durables financing</td>
<td>2%</td>
<td>1.1%</td>
</tr>
<tr>
<td>High</td>
<td>Credit cards and overdrafts</td>
<td>2.5%</td>
<td>1.64%</td>
</tr>
</tbody>
</table>
**Difference between IAS 39 collective impairment and dynamic provisioning mechanism**

As referred to previously, collective impairment under IAS 39 aims to reflect the loss events that have occurred with respect to individual assets in the group, but have not yet been identified on an individual asset basis.

The general provision under dynamic provisioning requires the bank to provide for expected losses on credit expectations through an economic cycle at the outset of the loan. This is currently prohibited under IAS 39.

Therefore, the key difference between the collective impairment as per IAS 39 and dynamic provisioning is not necessarily the level of provisioning but the timing of the provisioning.
Criticism of dynamic provisioning

Passing on regulator’s job onto accountants
Dynamic provisioning is a good technique for regulators to help them in assessing whether banks have adequate capital. Accounting for provisions using this technique will mean that accountants would be handed what should be a regulatory task – that of ensuring that banks hold enough capital.

Dynamic provisioning is inconsistent with IAS 39
Both do not compliment each other as dynamic provisioning is based on an ‘expected loss’ model whereas IAS 39 contends an ‘incurred loss’ approach to loan impairment.
Criticism of dynamic provisioning

IASB categorically rejected ‘through-the-cycle’ approaches (and specifically ‘dynamic provisioning’). The Board concluded that such approaches:

- do not use statistical information to forecast credit losses but rather rely solely on historical events to set out provisioning levels at the end of the reporting period, thus resulting in an allowance for credit losses that does not reflect the economic characteristics of the financial assets at the measurement date

- recognise an allowance for loan losses solely on the basis of conditions that may not be predictive of future credit losses

- recognise an allowance for loan losses on cycle-average credit losses when a financial asset is first recognised even though there is no economic loss from the asset in question
Criticism of dynamic provisioning

Manipulation of earnings

“Excess” reserves are associated with managing earnings, which is viewed as undesirable by the accounting profession.
**Criticism of dynamic provisioning**
Banco de España’s response

In maintaining a focus on the use of historical data in its approach to loan loss provisioning, Banco de España claims it has been able to adopt dynamic provisioning in compliance with IASB standards. Moreover, they argue that dynamic provisioning is the equivalent to the ‘collective assessment for impairment’.

They require banks to disclose separately the amount of the dynamic provisioning, apart from the specific provision. This means that users can ‘undo’ the impact of the dynamic provision on the profit or loss.
Criticism of dynamic provisioning
Banco de España’s response

By taking provisions early when economic conditions are good, banks will avoid using capital in an economic downturn when it is more expensive, thereby reducing the probability of failure from capital deficiencies.

They also emphasise that dynamic provisioning is a transparent system because it is rules and formula based. This means that banks are more comparable to each other.
Spain ... A live situation

Implementation issues noted were:

- Accounting and auditing implications
- Tax treatment of provisions
- Data warehouse and system requirements
Spain ... A live situation
What difference did dynamic provisioning make for Spain?

• Before dynamic provisioning was put into place in 2000, Spain had the lowest provision to non-performing loans ratios amongst OECD countries.

• In 2006, Spanish banks had by far the highest provision to non-performing loans ratio amongst Western European countries.

• Spanish banks entered the financial crisis with substantial reserve cushions relative to non-Spanish banks.

• Saurina (Head of Financial Stability at Banco de España) indicates that much of the pool of provisions amassed since the scheme’s inception was drawn on over the course of 2009, supporting financial institutions during the global financial crisis.
"Attributable profit of EUR 8,181 million was 8.5% lower than in 2009 and earnings per share were EUR 0.9418. The profit includes the impact of the EUR 693 million (EUR 472 million after tax) allowance resulting from the new Bank of Spain regulations on provisions (Circular 3/10) and their application under criteria of maximum prudence. Excluding this effect, attributable profit would have been EUR 8,653 million (-3.2%) and earnings per share EUR 0.9961."

Extract from Grupo Santander
Annual Report 2010
Spain ... A live situation
Impact on audit reports

In our opinion, the accompanying consolidated annual accounts for the year 2010 present fairly, in all material respects, the consolidated equity and financial position of Banco de Sabadell, S.A. and its subsidiaries as at 31 December 2010 and the consolidated results of their operations and consolidated cash flows for the year then ended, in accordance with International Financial Reporting Standards, adopted by the European Union, and other applicable provisions of the applicable financial framework.

In our opinion, the accompanying consolidated financial statements for 2010 present fairly, in all material respects, the consolidated equity and consolidated financial position of the Banco Bilbao Vizcaya Argentaria Group at 31 December 2010, and the consolidated results of its operations and its consolidated cash flows for the year then ended, in conformity with International Financial Reporting Standards as adopted by the European Union and the other provisions of the regulatory financial reporting framework applicable to the Group.
Criticism of the current model under IAS 39

- Unclear when to book or reverse a loss
- Changes in credit risk are not recognised on a timely basis
- Expected loss, which is implicit in the initial measurement of a financial instrument, is not reflected in effective interest rate (EIR)
- Economically, interest income is overstated before a loss event occurs, and there is then a ‘cliff effect’ when a loss event occurs
- A loss is recognised when a loss event occurs, even if original expectations have not changed
‘Expected loss’ model proposed by IFRS 9 (ED) Overview of approach

The proposed approach is built upon the premise that interest charged on financial instruments includes a premium for expected losses, which
- should not be included as part of interest revenue/income, and
- results in an allocation of the initial estimate of expected credit losses over the expected life of the financial asset.

The lender will be required to identify the EIR component at the inception of an instrument that represents compensation for the expected losses.

Interest income is recognised over the life of the instrument at the Effective Interest Rate (EIR), net of the expected loss component identified at inception.
'Expected loss’ model proposed by IFRS 9 (ED)
Example of specific provision - background information

• Bank Y issued one loan facility of €150,000 at a fixed interest rate of 10%. The principle is repayable in 5 years time (bullet repayment) whereas interest is payable annually at the end of each year
• Date of loan facility: 1 January 2010
• The EIR under the incurred loss model, excluding future losses, is 10%.
### ‘Expected loss’ model proposed by IFRS 9 (ED)

Example of specific provision - EIR under IAS 39

<table>
<thead>
<tr>
<th>Year</th>
<th>Opening amortised cost</th>
<th>Interest income</th>
<th>Cash inflows</th>
<th>Unadjusted amortised cost at year end</th>
<th>Income for the period</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
<tr>
<td>2011</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
<tr>
<td>2012</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
<tr>
<td>2013</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
<tr>
<td>2014</td>
<td>150,000</td>
<td>15,000</td>
<td>15,000</td>
<td>150,000</td>
<td>15,000</td>
<td>10%</td>
</tr>
</tbody>
</table>
‘Expected loss’ model proposed by IFRS 9 (ED)
Example of specific provision - background information

- On the basis of the information available at the time that the loan facility was provided, Bank Y’s best estimate of future cash flows (on a yearly basis), based on historical experience with clients of similar credit risk characteristics, is cash receipts of:
  - 31 December 2012 €14,250
  - 31 December 2013 €13,500
  - 31 December 2014 €140,250 (including repayment of principal)

- The above expectations are in fact already factored into the determination of the coupon rate (10%) that Bank Y charges the client
‘Expected loss’ model proposed by IFRS 9 (ED)
Example of specific provision - EIR under IFRS 9

<table>
<thead>
<tr>
<th>Year</th>
<th>2010</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Outflow)/Inflow</td>
<td>(150,000)</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
<td>165,000</td>
</tr>
<tr>
<td>Expected loss rate</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>5%</td>
<td>10%</td>
<td>15%</td>
</tr>
<tr>
<td>Recoverability rate</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>95%</td>
<td>90%</td>
<td>85%</td>
</tr>
<tr>
<td>Expected cash flows on inception</td>
<td>(150,000)</td>
<td>15,000</td>
<td>15,000</td>
<td>14,250</td>
<td>13,500</td>
<td>140,250</td>
</tr>
<tr>
<td>Present Value</td>
<td>(150,000)</td>
<td>14,040</td>
<td>13,142</td>
<td>11,686</td>
<td>10,363</td>
<td>100,769</td>
</tr>
</tbody>
</table>

Original EIR (expected-loss approach) 6.84%
### ‘Expected loss’ model proposed by IFRS 9 (ED)

Example of specific provision - amortised cost schedule

<table>
<thead>
<tr>
<th>Year</th>
<th>Opening amortised cost</th>
<th>Interest income net of allowances</th>
<th>Cash inflows</th>
<th>Amortised cost at year end</th>
<th>Income for the period</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>150,000</td>
<td>10,253</td>
<td>15,000</td>
<td>145,253</td>
<td>10,253</td>
<td>6.84%</td>
</tr>
<tr>
<td>2011</td>
<td>145,253</td>
<td>9,929</td>
<td>15,000</td>
<td>140,182</td>
<td>9,929</td>
<td>6.84%</td>
</tr>
<tr>
<td>2012</td>
<td>140,182</td>
<td>9,582</td>
<td>14,250</td>
<td>135,514</td>
<td>9,582</td>
<td>6.84%</td>
</tr>
<tr>
<td>2013</td>
<td>135,514</td>
<td>9,263</td>
<td>13,500</td>
<td>131,277</td>
<td>9,263</td>
<td>6.84%</td>
</tr>
<tr>
<td>2014</td>
<td>131,277</td>
<td>8,973</td>
<td>12,750</td>
<td>127,500</td>
<td>8,973</td>
<td>6.84%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>48,000</td>
<td></td>
</tr>
</tbody>
</table>

Total: 48,000

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Dynamic provisioning

PwC
Dynamic provisioning is a tool to calculate the ‘expected loss’ on a loan at inception. Therefore, the new accounting model currently being discussed for IFRS 9, the ‘expected loss’ model, is in synchrony with the logic behind dynamic provisioning.
## What are others saying on dynamic provisioning?

<table>
<thead>
<tr>
<th>Basel Committee</th>
<th>Basel III imposes a countercyclical capital buffer to ensure that the banking capital requirements take account of the macro-prudential environment in which banks operate.</th>
</tr>
</thead>
<tbody>
<tr>
<td>IASB/FASB</td>
<td>The Financial Crisis Advisory Group (FCAG) advised the IASB and FASB to explore alternatives to the incurred loss model for loan loss provisioning that use more forward-looking information. These alternatives include an expected loss model and a fair value model.</td>
</tr>
<tr>
<td>European Commission</td>
<td>The European Commission acknowledges that regulatory capital covers unexpected losses whereas dynamic provisioning is intended to address expected losses.</td>
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</tbody>
</table>
G20 countries Finance Ministers, acknowledged dynamic provisioning as a contributor to Spain’s banking sector’s soundness.

The Financial Policy Committee (FPC) of the Bank of England (empowered to establish macro prudential regulations) suggested forward-looking loss provisioning as one of the additions to the UK’s economic policy framework in July 2010.

In August 2011, Anand Sinha (Deputy Governor of the Reserve Bank of India) said that India has been trying to develop a methodology based on the Spanish dynamic provisioning system. This, however, has not been easy given the lack of required data and analytics with the banks.
Concluding remarks

Somehow or another, the banking industry needs to recover from the current crisis. A lot is being said but it is claimed not enough action has been taken compared to what is happening in the industry.

Basel III is earmarked as the new regulatory regime that will prevent the banking industry from experiencing similar fate.

And what about dynamic provisioning?
Thank you