#### Determinants of credit risk provisioning in uncertain times - the role of bank conditions and accounting standards

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This paper considers provisioning by IFRS vs GAAP banks in the euro zone since adoption of IFRS 9 in 2018

#### The paper finds that provisioning is

- Higher for IFRS banks
- Higher for well-capitalized banks
- Lower for guaranteed loans
- The paper further considers how the accounting convention affects:
  - Provisioning in response to the recent energy shock
  - Provisioning around the moment of a loan becoming nonperforming

#### Comments

- What affects bank choice to adopt IFRS 9?
- Does firm decision making enter the relation between provisioning and bank capital?
- Loan provisioning and:
  - Loan guarantees during COVID period
  - Capital relief for IFRS banks during COVID period
  - Supervisory expectations of provisioning for NPLs
  - Supervision by the ECB
- Does nonperforming loan status depend on accounting convention?

#### What affects bank choice to adopt IFRS 9?

- Some banks can choose between IFRS and GAAP. This is the case for banks without consolidated statements and/or that are not publicly listed.
- IFRS, however, only seems to have disadvantages:
  - It leads to higher average provisions
  - It is more complicated and hence costly
- This is unlike the analogous choice between Advanced Approaches vs.
  Standardized Approaches in risk weight calculation where the advanced approaches generate lower risk weights.
- Question: Does IFRS also generate higher provisioning for the subset of banks that have a choice?
- The relative use of Advanced Approaches in risk weight calculation could be used as an instrument to model selection of IFRS vs GAAP, as an alternative to the propensity matching approach in the paper.

### How to study IFRS vs GAAP while side-stepping the choice issue?

- Compare provisioning by banks that are required to adopt IFRS before and after IFRS adoption in 2018.
- Use information on provisioning under IFRS and alternative approach for IFRS adopting banks after 2018.
  - This information should exist as banks are allowed to add back to capital part of increase in provisioning under IFRS 9 during transition period (until 2024).
  - Are supervisory data on inputs into these capital adjustments available?

# Does firm decision making enter the relation between provisioning and bank capital?

- Schiantarelli, Stacchini and Strahan (2020, JF) show that Italian firms delay payments to weak bank if collateral recovery is slow.
  - Reason: Firms are less likely to receive credit from weak banks in the future as they may cease to exist.
- This can explain variation in repayment to different banks in a firm \* quarter cell, unlike the approach following Khwaja and Mian (2008)
- This could affect estimated relation between provisioning and bank capitalization.

# Provisioning and loan guarantees during Covid period

- Provisioning is negatively related to public loan guarantees, for instance in Table 4.
- There is evidence that riskier firms had a higher probability of obtaining a guaranteed loan in France (Théo Nicolas, Stefano Ungaro, and Eric Vansteenberghe, 2022).
  - This suggests there should be a positive relation.
- Why is the estimated effect negative?
  - In case of defaulted loans, this could reflect supervisory expectations that banks take at most 7 years to fully provision for secured loans, rather than 2 years in the case of unsecured loans.
  - Generally, do banks have incentives to evergreen loans subject to guarantees?
    Guarantees were up to 100% in Germany, Italy and the Netherland for some loans.

# Provisioning and capital relief for IFRS banks during COVID period

- In the EU IFRS banks received temporary capital relief during COVID to lessen impact of higher provisions on capital. Similar approach was taken in the US.
- This type of preferential capital relief could be integral to IFRS 9 adoption.
- This would make capital relief a key aspect of the relations between IFRS adoption, provisioning and capitalization.
- Empirically, could time dummy approach be used to see whether relation between provisioning and capitalization is looser during crisis for IFRS banks period because of capital relief?

### The energy price shock did not trigger capital relief for IFRS banks

- How big does a shock have to be for regulators to provide preferential capital relief to IFRS banks?
- The energy shock analyzed in the paper was not big enough, which enables the authors to study a shock that did not not trigger capital relief.
- However, the findings do not necessarily translate to a somewhat larger shock that triggers preferential capital relief for IFRS banks.

# Provisions and supervisory expectations of provisioning for NPLs

- The ECB's (2018) supervisory expectations stipulate full provisioning for unsecured NPLs within 2 years.
- Are these supervisory expectations binding?
- Is this different for IFRS vs GAAP banks?
- If supervisory expectations are binding, does the regression equation still apply?

#### A related point:

How does this study deal with loans that are written off? Are they deleted from the sample at the moment they are written off, or do loans that are written off during the relevant examination window never enter the sample?

#### Provisioning and supervision by the ECB

- IFRS banks tend to be larger, and hence are more likely to be directly supervised by the ECB
- Is the ECB stricter in enforcing adequate provisioning?
- Could that explain why IFRS banks have higher provisioning?

### Does NPL status depend on accounting convention?

- The paper examines provisioning around the timing of a loan becoming nonperforming loan.
  - This implies becoming a stage 3 loan under IFRS or getting a specific allowance under GAAP.
- However, the timing of becoming nonperforming could depend on the accounting convention.
- Under IFRS, loans could become nonperforming earlier, as assessment is based on forward-looking expectation, and not only on credit events. Is this the case?
- This is relevant for the analysis of the timeliness of provisioning around the moment of a loan becoming nonperforming.

#### Conclusion

Nice paper on a key topic for the operation of banks!