EUROPEAN BANKING AUTHORITY

# 4th EBA Policy Research Workshop

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Non-performing loans and credit losses – “Loan Loss Accounting Rules and Bank Lending over the cycle: Evidence from a global sample”

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# Outline

- Introduction
- Data
- Empirical results
- Robustness and Conclusions

# Introduction

- **Simple, relevant and interesting**
- **Cross-country differences** (info on local) **LOAN LOSS ACCOUNTING RULES**
- **Development of indices**
- **Contribution**
  - **Procyclicality of LOAN LOSS PROVISIONS** (vs banking regulation; mark to market accounting - fair values)
- Banks` ability to take
  - A FORWARD-LOOKING APPROACH (expected loss model – IFRS 9)
- BANKS` LENDING BEHAVIOUR more procyclical (higher fluctuation of banks' lending) if
  - Using BACKWARD-LOOKING LOAN LOSS ACCOUNTING RULES (incurred loss model – IAS 39)

# Data

- Different sources and data quality
- **4,575 banks; 52 countries**
- **NPLs with 5 Questions (BRSS Survey): Yes/No**; **aware of assumptions; better questions?**
  - Q2-Days in arrears if Yes=Forward-looking, if No=Backward-looking
  - Q2&Q3-Use of the word “primarily” as “exclusively”;
  - Q4-Minimum provisions required if Yes=Backward-looking (no flexibility)
  - Q1-Formal definition of a NPL if Yes=Backward-looking
  - Q5-General provisions, if Yes=Forward-looking

- **Indices (creation of 6 indices)**
  - Provisioning indices: ProvIndex (**Backward-looking: High Score** vs Forward-looking)

# Empirical results

- Dependent: loan growth rate Loans
- Interaction of Country´s nominal GDP growth rate * Accounting Indices [ProvIndex(1/2/3)b...] and [ProvIndex(1/2/3)a...]

- Descriptive statistics
- **Interaction** with positive and significant coefficients
  - **Higher Scores (i.e. more backward-looking provisioning) amplifies the effect of GDP growth** on

- **Control variables with expected signs**
  - **Higher equity ratios implies higher loan growth (robustness)**

# Robustness and Conclusions

- Several methodologies
- Sample composition
- **Results seem robust => Conclusions**

- Loan loss accounting rules => procyclical build-up of loan loss provisions =>
  - Lending behaviour procyclical if backward-looking provisioning (i.e. incurred loss model instead of expected loss model)

- More **details on**:
  - **Why?** (risk appetite/animal spirits; (credit) quantitative models; data; …)
  - **main driver(s)** of forward-looking provisioning to be less procyclical? (from questions: e.g. days in arrears? use of PD? use of general provisions?...)