# National Bank of Slovakia - remarks to CP 3

Remarks to the Third Consultative Paper (CP3) are decomposed into two groups: *general remarks* and *technical remarks*. General remarks concern mainly the application and implementation issues and do not refer to particular articles of CP3.

## *A. General Remarks*

### 1. Scope of application – systemic banks in local banking sectors

Under the condition of materiality, CP3 gives a possibility either to exclude some exposures and/or parts of a banking group (holding company) or not to apply an IRB approach or both. But an immaterial excluded exposure or a part could be a very material with respect to their localisation in a domestic banking sector or a subsidiary. This unregulated exclusion applied to a systemic bank in local banking sector could lead to a undesirable regulatory arbitrage and important growth of systemic risk in a domestic banking sector.

*Proposed solution*

Subordinate the approval of home country supervisor to the application of the same materiality criteria for exclusion on both the consolidated level and with respect to the local banking sector (or materiality within subsidiary /branch). E.g. if the used materiality criteria would be a 5 % limit on total assets the possibly excluded subsidiary with assets under this materiality limit within the holding should satisfy the same limit of 5% as to the total asset of the banking sector where the subsidiary is localised.

### 2. Data

Data are one of the most important implementation's issues. CP3 does not stipulate that for the application of more advanced approaches on solo basis the characteristics (PD, LGD, M and K) determined on that level should be used. Values of these factors on group wide level used on lower level could significantly underestimate credit and/or op risk on that level.

*Proposed solution*

Clearly stipulate that for the application on a given group level values of the risk characteristics which are relevant to that group level should be used.

### 3. Pools of Data

Present wording of CP3 gives a possibility to use data pools or external data. But especially in any values PD or LGD characteristics there are two parts. Namely, first which is controlled by willingness of a debtor to pay the debt and the second which is controlled by his ability to pay. This second part of the value of risk characteristics could be shared among different banks or part of a holding. But first part is strongly related to the quality of risk management process and risk culture within not only a bank but even within a given part (subsidiary, local branch) of a bank group. And this part of quantitative information could not under no circumstances be shared. So if we use a data pool within sectors and/or banking group with heterogeneous quality of risk management process and risk culture we could significantly underestimate risk profile of a bank and create a systemic risk in a banking sector. Other consequence could be the creation of a series of quasi-standardised approach to credit (op) risk what is not probably the intention of the Committee.

*Proposed solution*
Clearly stipulate that for the application of data pools (if any) the authorised supervisor must have strong assurance on homogeneity of risk culture and risk management processes within the unit under approval. When issuing the approval to use PD, LGD,… values the home country supervisor should seek an agreement/opinion of host country supervisors of any material subsidiary (branch) of the holding.

***B. Technical Remarks***

1. **To paragraphs 31, 32** (Claims on non-central government public sector entities – PSEs): Under these paragraphs there is the option (subject to national discretion) to decide about risk-weighting of claims on domestic PSEs – either as claims on banks or as claims on sovereigns in whose jurisdictions these PSEs are established. Referring to footnote No 14 certain PSEs may be treated as normal commercial enterprises and supervisors should decide to consider them as claims on corporates. In our opinion it would be better (for text simplification) to consider the last option in footnote No 14 under the next paragraph (for example 33). National supervisors should then have 3 options of how to treat PSEs – as claims on banks, claims on sovereigns or claims on corporates directly mentioned in the text of CP3.

2. **To paragraphs 55-59** (Off-balance sheet items): In comparison to the other elements of the Standardise approach to measure credit risk, that are described comprehensively and in detail, what is related to credit conversion factors (CCF), in these paragraphs only changes against Basel I are described. Due to the lucidity and comprehensiveness of the CP 3 text we suggest mentioning both changed and unchanged CCF in details.

3. **To paragraph 2** (Introduction): The scope of application of the Accord will be extended to include, on a fully consolidated basis, any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group. In CP 3 there is no definition of a holding company. Is this approach applicable in the case that there is an Insurance company instead of a Holding company (instead of a financial holding)? See the illustration of new scope of application of the Accord on page No 5.

4. **To paragraphs 241, 298, 299, 301** (Formula for derivation of capital requirement and risk weighted assets): Capital requirement (K) mentioned in these paragraphs is only the percentage form of capital requirement's volume against EAD. Due to the consistency of the Accord terminology it would be better to highlight as a capital requirement (K) what is at present called as K*EAD.

5. **To paragraph 38** (Claims on banks): Under this paragraph when the national supervisor has chosen to apply the preferential treatment for claims on the sovereign as described in paragraph 28, it can also assign, under both options 1 and 2, a risk weight that is one category less favourable than that assigned to claims on the sovereign, subject to a floor of 20%, to claims on banks with an original maturity of 3 months or less denominated and funded in the domestic currency. It seems that this risk weight is used in all the

rating categories, including claims on banks with the rating below B-. In another part of the Accord, in paragraph 52, it is mentioned, that claims on banks rated below B- will be risk weighted at 150% or higher. In these rating categories (below B-) there is a contradiction between paragraph 38 and 52. We suggest adding the limitation for the preferential treatment for claims on banks with an original maturity of 3 months or less denominated and funded in the domestic currency, into paragraph 38 – it should be applicable only for claims on banks rated above B-, claims on banks rated below B- should have risk weight 150%. Risk weight for claims on banks rated below B- should be explicitly mentioned in paragraph 38.