POLISH BANK ASSOCIATION

Warsaw, 27 June 2013

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland
baselcommittee@bis.org

RE: Polish Bank Association position on BCBS Consultative Document Supervisory framework for measuring and controlling large exposures

Dear Sirs,

The PBA welcomes the opportunity to share its view with the Basel Committee on the Consultative Document Supervisory framework for measuring and controlling large exposures.

General comments

The PBA fully support the efforts of the BCBS to review supervisory framework for measuring and controlling large exposures. After many new regulations recommended or implemented in last year it is necessary to review the their consequences for large exposure regime. The new definition of bank own funds can be sufficient factor to analyze its impact on the supervisory large exposure framework. The experiences of last financial crisis should be also taken in consideration during the present review.

Saying that, we have also take into consideration the capacity of banking sector and regulators to implement all times new supervisory framework. We should also have in mind the objective of each proposal of new supervisory regulations. In our opinion the objective of the LE framework should be limited to capturing the loss that a bank would likely incur if a single large counterparty defaults. Adding the objective of capturing systemic issues arising from interconnectedness is not only inappropriate, but also duplicates the other existing regulations that address the issue.

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The large exposure framework is meant to capture the loss that a bank would likely incur if a single large counterparty defaults. However, the current proposal seems to add the objective of capturing systemic risk arising from interconnectedness. We believe there are already several regulatory measures in place (e.g. additional capital for G-SIBs, recovery and resolution, FSB data templates, etc.) that are more appropriate to address systemic and interconnectedness issues. We suggest that the LE framework should stick to its original intended objective in order to make the framework as simple as possible – which is the stated intent of the BCBS.

Many proposal presented by BCBS in consultative document is to create higher requirements for banks. We are not convinced that the existing system of large exposure framework should be strengthened in such drastic way. We have not seen many clear evident during last crisis which would give reason for strengthening of large exposure framework. Particularly, the bigger reporting requirements are not useful, they may even be counterproductive when bigger amount of reports needed from banks will cause the bigger inflow of documents to supervisory authority and bigger difficulty in splitting the important and less important large exposure of banks. The experience from the past is not satisfactory in this area. We should have this in mind proposing the new stricter supervisory regulations.

Detailed comments

Scope of Application

The framework is aimed primarily at internationally active banks. However, national supervisors are free to extend the rules to other banks and to impose stricter rules which will make it difficult to achieve an international "level playing field." Therefore, we urge the BCBS to frame its rules as a uniform standard.

Within the a banking group the framework applies to full consolidated and sub-consolidated levels. It may make it difficult to achieve an international "level playing field"., because being or not the member of international banking group will decide about the scale of requirements and limits put on the banks competing on local financial market.

Definition of Large Exposures

In many jurisdictions, the definition of large exposure amounts to 10% of the eligible capital. The PBA is not in favour to reduce this definition to 5% eligible capital because it would lead to a progressive increase of clients to be reported. Consequently, banks would be faced with a significant increase of processing costs, which would also arise solely by the fact that these

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loans must be monitored continuously during the quarter, dramatically increasing the operational burden.

In addition, we cannot see the rationale behind lowering the large exposure reporting threshold. Should macro prudential purposes be the reason, we would like to emphasise that we consider the large exposure regime as inadequate to obtain valid data for a meaningful analysis of macro prudential risks. Firstly, the large exposures regime alone is solely the limitation of credit risk. Other risks are not explicitly considered here. Such risks can be much better assessed by other regulatory and statistical reports.

We do not understand the idea to introduce the additional, lower limit if the number of "classical" large exposure is lower than 20. This information does not give additional value to the supervisor. It will cause additional requirements for banks and sometimes the potential negative impact of risk connected with these assets is very limited for bank stability.

The definition of large exposures limit of 10% of eligible capital is significantly below the large exposure limit of 25%. This should be sufficient as an early warning indicator of a regulatory limit of 10%. That is why we are in favour to leave the reporting threshold at 10% of the eligible capital and to refrain from reporting the 20 largest borrowers.

Connected clients

First and foremost, the LE rule should be based on accounting consolidation. We understand that the large exposure framework may need to capture connected counterparties based on the control relationship criterion. However, we do not think rules on connected counterparties based on economic interdependencies could be consistently and effectively implemented.

Capturing indirect client relationships is quite subjective and very dependent on a strong understanding of the clients business and business relationships. It is very difficult to make prescriptive rules that would adequately capture these relationships. For example, looking at implication of supplier relationship could be very industry specific and in some instances are dynamic in nature. In addition, as experienced with the rules currently in place in the EU, trying to capture "connected" entities is a highly manual, imperfect exercise. When investigating possible connections among counterparties on the basis of economic interdependence, it should be made clear that a group of connected counterparties will be deemed to exist only if the default of one party would lead to existence-threatening funding or repayment difficulties.

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The qualitative judgments needed to determine economic interdependence could vary significantly across banks and jurisdictions, thus, could lead to inconsistent implementation. Different banks will approach the process with different levels of understanding and diligence but yet be subject to the same LE limit. For example the notion "substantial part" expressed in paragraph 34 are not precise. This goes against the Basel Committee's objective of having internationally consistent rules.
Furthermore, we have concerns regarding the operability of the proposal in paragraph 36. Firstly, it is unclear what is meant by a "set of counterparties." On the other hand, an institution should know before applying the threshold where potential dependencies are presumed. We therefore prefer a link to the respective exposures to one client. That means that an institution would have to analyse economic interdependencies intensively if the exposures to one client would exceed 2 % of the eligible capital. A centralised database that contains group structures would be helpful to reduce the administrative burden. Also, the requirements mentioned in paragraph 32 may not always be available or very hard to find out.

We would like to highlight that the experience with the existing interconnectedness framework in the EU to understand the materiality and usefulness of the information being collected should be studied before it implements any new guidance.

We also express the view that the cost associated with assessing economic interdependence far outweighs the benefits. Doing the assessment would be a complex process and yet the exposures that would be captured would most likely be not material for most, if not all, banks. The complexity involved also does not meet the Basel Committee's objective of having a "simple large exposures framework".

Capital measure for Large Exposure Limit

We prefer widening the scope of application to going concern capital and Tier 2 capital. Intuitively it makes sense to align the capital definition as well. The retention of a 25% large exposure limit then would be more appropriate. The reference to the eligible capital, which is due solely from CET1 or Tier 1, is a drastic worsening compared to the status quo. By revising the definition of capital via Basel III the qualitative requirements for capital instruments have highly increased providing therefore "better" capital loss absorption.

Given that Basel III has made the qualitative requirements that capital instruments need to meet considerably more stringent, then there is no reason why additional T1 (AT1) and even Tier 2 (T2) capital should be excluded. For example, T2 capital instruments are required to

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include mandatory conversion or write-down features linked to the issuer's financial strength that are capable of absorbing losses on a "going concern" basis.
In addition, we do not find excluding general provisions in the LE limit appropriate given that these are held against future losses on the same exposures (albeit unattributed) that are subject to the LE limit. Paragraph 43 explains why the BCBS excludes general provisions from the denominator of the LE limit. It explains that LE rule is aimed at capturing unexpected losses but losses absorbed by general provisions are not unexpected. However, if the capital measure excludes all elements that absorb expected losses (i.e. general and specific provisions), then the exposure measure should also do the same and not just limit it to exposures covered by specific provisions. However, we appreciate that this is not easy to do in the case of general provisions since they are not attributed to any particular exposure. Hence, the easiest way and the more symmetric and appropriate treatment would be to recognize general provisions in the capital measure.
If the full T2 capital is not allowed for LE purposes, we believe that at least a proportion should be included to recognize its enhanced loss-absorbing features. This would also mitigate the significant reduction in allowable exposures that would result from tightening the exposure measure.
However, if it comes down to a choice between CET1 and T1, we believe it is more appropriate to use T1. This would also be consistent with the Basel leverage ratio, which is also a "backstop" measure.

Exemptions to Large Exposure Limits

We welcome the proposal to exempt intraday-day and overnight interbank exposures meeting certain conditions set out in §102 of the consultative document, i.e. the exposures relate to certain types of services, the exposures arise from client activity and the exposures arise for the purpose of monetary implementation.

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