International Banking Federation

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

tel: + 44 (0)20 7216 8947
fax: + 44 (2)20 7216 8928
web: www.ibfed.org

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

October 11, 2013

Dear Sir/Madam:

Re: Response to the BCBS discussion paper: The regulatory framework: balancing risk sensitivity, simplicity and comparability

The IBFed appreciates the opportunity to comment on this Basel Committee on Banking Supervision (BCBS) discussion paper, which addresses the complexity of the regulatory framework and its consequent impact on the comparability of capital adequacy ratios across banks and jurisdictions.

The IBFed agrees that the pursuit of increased risk sensitivity over the years has considerably increased the complexity of the capital adequacy framework in some areas. We would generally support efforts to simplify the regulatory and capital framework, where possible, as long as the effectiveness of internal risk models and the strength of the overall regulatory framework are not compromised.

We set out our views on this issue in an effort to help the BCBS achieve the appropriate balance between the complementary goals of risk sensitivity, simplicity, and comparability.

Internal Models

The IBFed strongly believes that, in most cases, internal models – when used appropriately – provide more accurate and refined measures of risk than simpler, standardised models. We also wish to note that such internal models undergo a significant amount of continuous internal scrutiny within the bank itself, as well as by national supervisors. The internal models based approach provides banks with appropriate incentives to develop, refine, and test, more sensitive measures of risk that can lead to better measurement of expected loss as well as the determination and allocation of capital. While these models may appear to be complex, this is often a reflection of the growing complexity of financial markets. The BCBS should be reassured that banks assess the appropriateness of internal models in order to reduce any undue complexity contained in these models, so long as the integrity and effectiveness of these models is maintained.

Simplicity

We do not believe that all risk models should be 'simple'. Instead, we believe that risk models should not be unnecessarily complex and that any increased complexity must be justified by corresponding risk measurement benefits.

Comparability

The IBFed believes that capital adequacy ratios should be broadly comparable within national boundaries as well as across borders. The consultative document notes several reasons why these ratios may not be comparable across banks with similar risk profiles, which could include bank-specific inputs and drivers of risk models that measure similar risks differently, or because of discretion taken by national supervisors. Nonetheless, we believe that a certain level of differentiation among banks can be reasonably justified, as differences in risk management knowledge, skills, and capabilities, as well as in business models and practices, could result in appropriate differences in risk measurement across banks. However, comparability among banks could be enhanced by a well thought-out disclosure framework.

The IBFed believes that improved comparability would increase investor confidence in the banking industry and therefore could serve to improve the overall stability of the financial system.

Disclosures and Comparison with Standardised Approaches

IBFed member banks have recently been devoting large amounts of resources towards meeting new international and domestic disclosure requirements, including those of the Enhanced Disclosure Task Force. While the IBFed generally recognizes the value of some of these new disclosure requirements, we are concerned that these ever increasing disclosure requirements are not contributing to transparency as intended, but instead adding to the overall complexity of the regulatory framework.

Nevertheless, the IBFed believes that more effort should be directed toward educating the users of such disclosures. An improved understanding of risk models developed internally by banks, and those provided to banks by supervisors (in particular the internal-rating based (IRB) model), would improve comparability and help alleviate some concerns over complexity. Disclosures could be targeted to various levels of expertise, from experts (e.g., supervisors), to analysts, to the general public.

The IBFed recognizes the value provided by standardised credit risk approaches to modelling losses, especially for those banks that do not have the capability to develop internal rating-based approaches to provide the inputs into the IRB formula. It would of course be possible for IRB banks to also calculate the losses (minimum capital requirement) using the standardised credit risk approach. However, we would have serious concerns over disclosing the results of these models publicly, as their results could be misinterpreted by users. For example, users may misinterpret standardised measures of risk to be the "correct" measure of risk, and therefore view lower measures of capital produced by the IRB risk models as being "faulty" or overly aggressive, whereas the standardised results are intended to be conservative. The IBFed believes that with respect to credit risk, the results of standardised approaches cannot be compared against IRB portfolios. Thus, if they are required to be calculated, they should generally remain confidential supervisory information.

We thank you for taking our comments into consideration and look forward to future discussions on these issues.

Yours sincerely,

Mrs Sally Scutt
Managing Director
IBFed