Basel Committee on Banking Supervision Second Consultative Document Standards
Revisions to the Standardized Approach for credit risk – **Our comments**

We welcome BIS acknowledging the importance of external ratings which would be the primary basis of arriving at risk weights for exposures to banks and corporates. We also are in broad agreement with the principle that the approach would reduce mechanistic reliance on ratings and may be subject to due diligence requirements, which could result in a higher risk weight than that determined by ratings.

Issue specific remarks are given below

Issue	**Our comments**
Exposure to Banks a) External Credit Risk Assessment Approach (ECRA): As a starting point, a bank would determine the "base" risk weight of an exposure based on the external rating of the counterparty/exposure. The bank would perform due diligence to ensure that the external rating appropriately and conservatively reflects the credit risk of the exposure. If the due diligence assessment reflects higher risk characteristics than that implied by the external rating of the exposure, the bank would apply a higher risk weight for the exposure	We agree with this approach
Banks' external ratings as used for regulatory capital purposes (in respect of banks other than Government owned banks) should exclude government support. Since the Committee recognises that bank ratings without government support may not be currently available, the Committee welcomes feedback from market participants and credit rating agencies to assess the feasibility and appropriateness of implementing this proposal.	We note the Committee's view that external ratings of banks that are used for regulatory capital purposes should exclude government support. We do not believe that the link between financial institutions and the relevant sovereigns should be omitted from all credit risk considerations. This would otherwise be detrimental to the objective of risk-sensitivity of the standardized approach. Even if attempts were made, we believe that trying to remove any consideration of government support from credit ratings may prove difficult to implement. It would require a detailed, common definition of government support. Consideration would need to be given, for instance, to whether only potential future support should be excluded, or whether this

	exclusion should also extend to support already received or committed. Questions would arise as to whether central bank liquidity support should be included in the definition of government support, although access to central bank liquidity – sometimes on an exceptional basis – is a key feature underpinning banks' business models. We believe that trying to exclude government support from ratings would materially increase the complexity of the framework. We believe that other regulatory developments, such as progress in resolution regimes and increased regulatory oversight of capital and liquidity, may more effectively operate to reduce or break the links between banks and their sovereigns. We note that the treatment of sovereigns, central banks and public sector entities is not within the scope of the current proposals. Nevertheless, it is worth noting that, in assessing the credit risk of sovereigns, consideration is typically given to any liabilities that might arise in the event of financial institution distress. Similarly, where there is effective government support for systemically important banks, we believe that this embedded credit enhancement should continue to be appropriately recognized. Further, we believe that in certain extreme market conditions, exceptional government support – whether in the form of liquidity support or more – may reduce the pace of deterioration in the creditworthiness of banking systems, and hence the volatility in ratings. Finally, under our framework, external support may take different forms, government support being only one of them. Removing only the uplift related to government support could hamper comparability. While national Supervisory discretion may be exercised in requiring baseline ratings and support ratings separately as some rating agencies already do to add to information available to regulators and investors alike, we believe that for the sake of comparability and risk sensitivity, the credit rating rather than a

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<tr><td></td><td>baseline or standalone assessment should be employed.</td></tr>
<tr><td>Risk weights adopted in ECRA approach:
<table>
<tr><th>External Rating</th><th>Risk Weight</th><th>Short term exposures</th></tr>
<tr><td>AAA to AA-</td><td>20%</td><td>20%</td></tr>
<tr><td>A+ to A-</td><td>50%</td><td>20%</td></tr>
<tr><td>BBB+ to BBB-</td><td>50%</td><td>20%</td></tr>
<tr><td>BB+ to B-</td><td>100%</td><td>50%</td></tr>
<tr><td>Below B-</td><td>150%</td><td>150%</td></tr>
</table></td><td>This approach is in line with our comments on the
previous paper and gives due weightage to the external credit ratings. However, there may be a case for different risk weight for A and BBB categories.</td></tr>
<tr><td>b) In jurisdictions that do not allow use of external ratings for regulatory purpose (Standardised Credit Risk Assessment Approach – SCRA) and for unrated exposures in jurisdictions where external ratings are used, exposures are to be categorized into three:

Grade A (50% risk weight): Banks which have adequate capacity to meet financial commitments irrespective of economic cycles (to be assessed based on published regulatory thresholds – leverage, liquidity and risk based ratios as well as bank's own assessment)

Grade B (100%): Credits subject to substantial credit risk with repayment capacities dependent on stable or favourable economic/business conditions. Applicable to banks which breach one or more of regulatory thresholds

Grade C (150%): Exposures with material default risks, which have breached binding minimum regulatory thresholds or auditor has expressed doubt that bank is a going concern</td><td>We are agreeable to this approach</td></tr>
<tr><td>Risk weight floor
Where external ratings are not available or used, the risk arising out of macro- economic factors this may be reflected by incorporating country ratings (eg OECD country ratings) as an objective criterion</td><td>Risk weight floor may be based on risk weight applied to the sovereign (assigned by ECAIs), as these ratings would be incorporating these risks and would be subject to continuous review.</td></tr>
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<td>for each grade bucket, or by imposing a risk weight floor based on the risk weight applied to the sovereign exposures (as a proxy).</td>
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<td>Reducing mechanistic reliance on ratings and enhancing the role of due diligence processes might impair the comparability of capital requirements. To address this concern, the Committee is considering whether to further enhance disclosure requirements.
In particular, the FSB Principles recommended that, in order to provide market discipline, banks should publicly disclose information about their credit assessment approach. The Committee welcomes feedback on the appropriateness of implementing this recommendation.</td>
<td>We are agreeable with the suggestion</td>
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<td>Exposure to Corporates

Two proposed approaches to risk-weighting corporate exposures:

a. In jurisdictions that allow external ratings for regulatory purpose (External Credit Risk Assessment Approach - ECRA)

For rated exposures, banks to determine “base” risk weight according to external rating (see below). Then conduct due diligence analysis which may result in the application of higher risk weight than determined by external rating. Due diligence cannot result in a risk weight lower than that indicated by external ratings.

<table>
<tr><th>External Rating</th><th>Base Risk Weight</th></tr>
<tr><td>AAA to AA-</td><td>20%</td></tr>
<tr><td>A+ to A-</td><td>50%</td></tr>
<tr><td>BBB+ to BBB-</td><td>100%</td></tr>
<tr><td>BB+ to BB-</td><td>100%</td></tr>
<tr><td>Below BB-</td><td>150%</td></tr>
<tr><td>Unrated</td><td>100%</td></tr>
</table>
For unrated exposures, 100% risk weight to be applied as is the current approach (except where exposure is in default)</td>
<td>Credit rating agencies make a clear differentiation between investment grade (BBB- and above) and sub-investment grade (BB+ and below) ratings wherein the latter display distinctly higher default rates. Rating agencies make a distinction between BBB and BB categories as indicated by their definition too: It is evident from these that, the risk profile in the BBB band is meaningfully different from risk in speculative grade ratings. Default studies clearly demonstrate this as well. Hence, it would not be appropriate to equate the risk weights for BBB and BB categories at 100% as proposed.

Rather, the BB bracket should have a risk weight in between the BBB and below BB- risk weights i.e. at 120% or 130%, in order to capture this distinction in credit risk profiles. Risk weight of 150% for ratings below BB- appears fine.

The treatment of unrated exposures appears to consider these as being equivalent to BB and BBB level rated issuers. We do not believe that this is appropriate, as in our view these issuers are typically less transparent than rated corporates and we believe therefore that a higher risk weighting should be applied.

Unrated exposures should carry 120% or 130% risk weights i.e. equivalent to BB+ to BB- rating as suggested by us above. This is because the</td>
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	corporates should be incentivized to improve their credit so as to be in the investment grade (AAA up to BBB-). Else, corporateswould prefer to be unrated, if they fall below A-.
b. In jurisdictions that do not allow use of external ratings for regulatory purpose (Standardised Credit Risk Assessment Approach – SCRA) A bank would assign a 75% risk weight to corporate exposures to counterparties that meet the definition of "investment grade", as below: "Investment grade" defined as entities that have adequate capacity to meet their financial commitments in a timely manner, irrespective of the economic cycle and business conditions. When making this determination, the bank should assess the entity against the investment grade definition taking into account the complexity of its business model, performance against industry and peers, and risks posed by the entity's operating environment. Moreover, the following conditions will have to be met: - Corporate entities (or the entity's parent company), must have securities outstanding on a recognised securities exchange; - The creditworthiness of these "investment grade entities" is not positively correlated with the credit risk of the exposures for which they provided guarantees. For all other corporate exposures: A bank would assign a 100% risk weight (unless the exposure is in default).	In the absence of external rating, we are not sure of an objective way of assessment of counterpartiesinto 'investment grade' or otherwise. The condition that the securities of entity or its parent has to be listed in a recognized securities exchange may be too simplistic an approach.
Risk weight for unrated SME exposures to be at 85%	More than one rating agency in ACRAA has responded that practical experience suggests that, risk - weight of only 85% for unrated SMEs may not be advisable. In our view, given the inherently high risk of default of SMEs, their base risk weight should be equated to the BB category risk weight at a suggested risk weight of 120% or 130% and should not be kept at a lower level.
Specialized Lending Exposures to Corporates	We concur with this approach.

Consistent with the reintroduction of external ratings for risk-weighting exposures to banks and corporates, the Committee also proposes to reintroduce the use of external ratings for specialised lending exposures. In particular, the Committee proposes to use issue-specific external ratings for project finance, object finance and commodities finance. The applicable risk weight would be determined by the same risk-weight look-up table that would apply to general corporate debt exposures.	
Subordinated debt, equity and other capital instruments Subordinated debt and capital instruments other than equities will receive a risk weight of 150%	While assigning ratings to subordinated debt instruments, rating agencies consider the nuances of subordinated debt for issuers and uses a 'notching down' approach for rating such debt instruments, vis a vis senior debt. Hence, applying a blanket 150% risk weight may not be appropriate. This can also be linked to external ratings.

GENERAL COMMENTS:

We welcome the Committee's decision to reintroduce external ratings in the second consultative document following the general consensus among respondents (of the first consultative document) that external ratings on corporate loans and bonds remain reliable indicators of default risk. This support for the continuing use of external ratings in the revised standardised approach (SA) confirms the utility of CRA credit ratings.

Since much is said throughout the consultative document on balancing risk sensitivity and complexity, we are of the view that the standardised approach (SA) should consistently reflect the following key underpinnings:

a) risk sensitivity should prevail over economic and/or social-related considerations in the selection of risk weights proposed by the Committee for different asset classes (SME lending, PSEs, sovereigns, unrated credits, etc) to reflect the credit risk entailed in these exposures more accurately; this is reflected in the specific observations made in the table above.

b) National supervisors are in the best position to consider the potential ramifications of risk weight changes on banks' lending incentives (and any corresponding predisposition to herding behaviour). At the same time, we are mindful that the national regulators have other tools at their disposal to help prevent bubbles and the build-up of financial imbalances in addition to bank capital regulation.

c) apart from (b), discretion also needs to be given to national supervisors to avert potential untoward effects of risk weight changes on credit pricing and rationing, and ultimately the deployment of credit across the economy. Certain borrowers might become uneconomic to service. It is also important for alignment to be strengthened between the SA and advanced approaches to address the critical level playing field issue. If not, smaller banks could struggle to compete against the larger banks for lower risk assets, consequently skewing the portfolios of the smaller banks towards weaker credits;

d) national supervisors should ensure that risk weights are calibrated against factual experience when assigning eligible ECAIs' ratings to the risk weights under the SA framework; this goes back to reducing the need for bank specific due diligence of each rating, although we in general remain in agreement to banks' due diligence.

e) we believe that balance between risk sensitivity and complexity would be better achieved by providing more granularity in the Grade A band with respect to the three risk-weight buckets proposed under the SCRA on page 29, paragraph 19.