



Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
Basel, Switzerland

Brussels, 10th March 2016

Subject: Response to the consultation on the revision to the SA for Credit Risk.

Dear Sir/Madam,

We welcome the opportunity to provide a response on the second consultative document on *Revisions to the Standardised Approach for credit risk*.

European Development Finance Institutions (EDFI) is the Association of 15 bilateral institutions operating in developing and reforming economies, mandated by their governments to

- foster growth in sustainable businesses,
- help reduce poverty and improve people's lives and
- contribute to achieving the Sustainable Development Goals

We promote economically, environmentally and socially sustainable development through financing and investing in profitable private sector enterprises. Several of the EDFI members are either directly or indirectly subject to banking supervision, but none of these institutions is mandated to take deposits.

Over the last years we have observed a sharp increase in the required capitalisation for EDFI's under (indirect) banking supervision¹². The proposals in this consultative document are a continuation of this trend. Specifically, this proposal raises the following concerns:

- The consultation document proposes a further increase of capital requirements for institutions that invest in developing countries and markets via products that are traditionally perceived as of higher credit risk. However, the proposal does not recognize the benefit of a high level of diversification over countries, regions, sectors and vintage years that is key to the business model of our members. Even more so, this high level of diversification is one of the main reasons for the overall low credit risk profile and stable capitalisation of development financial institutions. Our suggestion would be to allow for a reduction in Risk Weighted Assets for developmental finance institutions with a globally diversified portfolio.

¹ In particular the rules for Subordinated Debt and Equity investments in Financial Sector Entities have had impact on the required capitalization of several members. In our view an unintended effect as the financial sector is one of the focus sectors of developmental finance institutions because of the developmental impact that can be achieved.

² The EDFI member COFIDES has opted to abstain from taking part in this response as COFIDES would need a deeper knowledge of the effects of this proposal.



- We consider the proposed equity weightings to be conservative, particularly for banks that are managing a portfolio of equity (fund) investments. Research has shown that capital at risk of a diversified (private) equity fund portfolio tends to be much lower. A combination of both diversification strategies and a globally diversified private equity portfolio can even result in zero invested capital at risk.³ We would therefore propose to take this into account when deciding on risk weights for (private) equity (funds). We would like to emphasise that the equity investments of our members enhance the stability in financial markets by increasing the availability of capital in capital scarce markets. As an equity provider, development financial institutions can have a beneficial influence on companies (hands-on management, enhanced corporate governance and institution building) that can help to achieve the desired effect of economic welfare for developing countries. According to the mandates of Development Finance Institutions, equity and mezzanine are constitutive factors of our core business. A substantial tightening of minimum capital requirements undermines the business model of development finance institutions and thus their promotional mandates.
- The consultation document proposes the introduction of a 50% add-on for corporates with non-hedged currency mismatches. We recognise that higher risk weights for non-hedged currency mismatches are justified as they are a source of higher credit risk. When we compare the risk weights of already defaulted engagements to the risk weight of an investment in a non-rated company in a mismatching currency, we consider the risk in the latter case to be overestimated. We suggest a significantly lower add-on for currency mismatches as the risk weight currently envisaged is not justified by the risk taken. We suggest an add-on of 20% which should reflect the surplus risk more adequately. From a Development Finance Institution point of view this issue is of the utmost importance as our customers often strive to contract in hard currencies (EUR and USD) because of the missing market in local currencies.

We witness that the increased capitalisation requirements directly affect our ability to provide the financing needs of our already underserved markets. We hope the BCBS will consider our arguments in its policy settings. We are at your disposal for further elaborations on this issue.

Yours sincerely,

Nanno Kleiterp
Chair of EDFI

³ <http://www.capdyn.com/media/1305/pe-mathematics-apr2009-assessing-the-risk.pdf>