

Bank ABC Response

It is mentioned that the Standardized Approach (STDA) is a global minimum standard and that it is not possible to take into account all national characteristics in a simple approach. However, this implicitly refers to the fact that given the regional realities risk may be overestimated especially in context of scant ratings in the region. Given the current economic stress, while maintenance of safety and stability of financial system is of importance to the jurisdictional Supervisor, a balance must be maintained so that Aggregate Demand in the economy does not suffer, since there is limited Supply of capital under these circumstances.

- There are a number of specific observations, though perhaps the greatest impact regionally will be the impact for unrated Specialized Lending, Object Finance and Commercial Real estate exposures defined as “land acquisition, development and construction” (hereinafter called ADC) i.e. Loans to companies or SPVs, unfinished property meeting the definition of Specialized Lending).
- There is also a lack of clarity for several aspects, including bank ratings and Risk Weight add-in for exposures with currency mismatch.

a. Bank Ratings: Ref: 1.1.1(a) pp 4

External Credit Risk Assessment Approach (ECRA): The Committee believes that Bank external rating as used for regulatory capital purposes should exclude government support. Without an appropriate internal model, this cannot be quantified and internal models cannot be used under Standardised Approach. Hence, BCBS is requested to provide a decision framework to quantify government support or to allow usage of model for computation without Government support. This guidance should be communicated at BCBS level to avoid disparate treatment of one bank at multiple locations.

b. Unrated Banks: Ref: 1.1.1(a) pp 5-6

Standardised Credit Risk Assessment Approach (SCRA): Unrated Banks are classified into Categories A, B and C depending on their adherence or otherwise to the published minimum regulatory requirements (e.g. leverage, liquidity and risk-based capital ratios) and buffers (e.g. GSIB surcharge, capital conservation and countercyclical capital buffers) in respective jurisdictions. This will be very difficult to implement in practice, particularly in MENA jurisdictions, where some banks are unrated. *In practice, this makes the entire computation process very manual and subject to tracking the individual components of capital against jurisdictional requirements. This will only be possible if this is monitored by a reliable information provider (e.g. Bank scope). Further, since in some jurisdictions the CRDIV type Basel III triggers do not exist, BCBS should provide alternative guidance for classification of unrated banks.*

c. Risk Weight Floor Ref 1.1.1 pp 6

Consideration of the sovereign risk weight floor as a proxy (based on OECD country ratings) is acceptable only if the exposures are funded in a different (foreign) currency. Further, this must implicitly mean corporate exposures as otherwise it is in contravention to the guidance provided on Bank Ratings (i.e. they have to be considered without government support)¹.

d. Specialized Lending Ref 1.5.3. pp 14 & para 41 pp 32

41. For specialized lending exposures for which an issue-specific external rating is not available, and for all specialized lending exposures of banks incorporated in jurisdictions that do not allow the use of external ratings for regulatory purposes, the following risk weights will apply:

¹ However, this has been recorded under the SCRA approach for unrated banks.

- *Object and commodities finance exposures will be risk-weighted at 120%;*
- *Project finance exposures will be risk-weighted at 150% during the pre-operational phase*

Increasing the RW of pre-operational phase to 150% will have material impact on CAR. This includes ADC for Commercial Real Estate but more specifically Specialized Lending projects.

Risk weights are likely to limit banks from doing Infrastructural Project Finance business on account of considerably higher risk weight. This is particularly damaging in the current economic scenario, where governments are pulling back on project funding due to budgetary constraints and going the Build-Operate-Transfer (BOT) / Public-Private-Partnership (PPP) route, where projects will be financed on a project finance basis.

e. Object Finance: Ref: Para 41 pp 32

Similarly, a 120% flat Risk weight on Object Finance may directly result in reduction of economic activity (e.g. financing for ships/ aircrafts), despite these are backed by sufficient tangible security. If BCBS has access to Loss information globally relating to this segment, that indicates an enhanced capital requirement, please make it available, as our experience is to the contrary.

In the above cases (d & e), it is expected that there will be scant external ratings for the Specialized Lending Projects (in MENA region), the full brunt of this will be borne by the Lending Banks, having unintended consequences for public spending and capital formation in the region, and restricting banks to do “narrow banking”, thus leading to unintended concentration in the Banks’ portfolio. A viable solution for this is to use the IRB type Slotting Criterion provided the exemption to use this can be provided. This does not technically require the use of external models and can easily be adopted by the Standardised Banks.

f. Unconditionally Cancellable exposures: Ref: 1.7.1 pp 15 & Table A pp16

On the corporate side, the impact can be significant. The Committee wants to narrow the scope of the unconditionally cancellable exposures *in practice* to retail exposures only, classifying all other exposures as General Exposures with CCF of 50%-75%. This we think is extremely harsh since there will be extremely high capital charges, especially when it can be proved by documentation that these indeed are unconditionally cancellable. A simplified linkage to IRB level CCFs (even for unconditionally cancellable facilities) is not correct: this should be as per National Discretion and as per the precise nature of documentation.

The impact on the retail side of 10-20% is relatively acceptable.

g. Risk weight add-on for exposures with currency mismatch Ref: Para 62 pp 38

62. For corporate, retail and real estate unhedged exposures where the lending currency differs from the currency of the borrower’s main source of income, banks will apply an add-on of 50% to the risk weight applicable according to paragraphs [31 to 60], subject to a maximum risk weight of 150%.

We disagree with the quantum and the way of implementation of the proposal.

- First, this totally ignores structuring and relative ranking of the facility, where the waterfall is set up to favour the Foreign Currency lenders over those lending in Local Currency.
- Secondly, the issue of obligor funding mix. If for instance, the funding currency for this bank matches the borrower’s main source of income but a majority of its funding mix is in another currency, the lending bank will get a favourable risk rating (because there is no currency mismatch) whereas the obligor may actually face a higher risk. Unless this funding mix is

incorporated into the computation of risk weight it can have unintended consequences. Other than this, it is quite excessive² and will most certainly discourage lending.

- Another specific exemption which will be needed particularly for the GCC is for the pegged currencies. BCBS could consider exemption of highly rated Sovereigns from this requirement.
- Thirdly, depending on the (historical or prospective) volatility of the currency, there could be some distinction between freely traded currency pairs to accommodate differential risk recognition.
- Finally, given the change in the nature of the business, automating recording of currency with “main source of income” in the risk and finance systems will be operationally quite difficult, especially if we look at borrowers and lenders in multiple jurisdictions.

We would request BCBS to re-consider these aspects through clarifications and National Discretion.

² When compared with other currency mismatches e.g. between exposure and collateral.