March 10, 2016

Task Force on Standardized Approaches
Basel Committee on Banking Supervision
Centralbahnplatz 2, Basel, Switzerland

Re: Comments on the proposed 2nd revisions to the credit risk standardized approach

Dear Mr. Pierschel:

On behalf of Asian Bankers Association, we would like to express our earnest appreciations for the opportunity to participate in the TFSA industry hearing meeting in BASEL on February 17 and to deliver our comments on the Basel Committee on Banking Supervision's (BCBS) proposed revisions to the credit risk standardized approach (the 'proposal').

We recognized the importance of the revision of the credit risk SA and acknowledged the challenges the work will face. The Association and our members are ready to collaborate with TFSA in completing its work, including the QIS. Please refer to the document attached herewith as the formal comments from ABA for your consideration.

Should you have questions on our comments, please feel free to contact us.

Very truly yours,

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(Internal)

Comments on BSBC 2nd revision to Standardized Approach of Credit Risk

ABA (Asian Bankers Association)
2016 March 09

General Comments

- We appreciate BCBS's effort to facilitate the objectives of the revisions to enhance the comparability and alignment of treatment under IRB approach and across jurisdictions. The objectives appropriately allay cherry-picking and level-playing-field concerns. We also recognize the challenges in trying to balance amongst simplicity, comparability, and risk sensitivity.
- We appreciate BCBS's removal of the risk driver approach and reintroduction of external ratings for bank and corporate exposures. Current proposal is consistent with credit evaluation and assessment process in banks.
- We appreciate BCBS adopting industry feedbacks and reducing implementation difficulty in the second consultative document. Notwithstanding, banks still need time to modify IT systems and operational processes to comply with the finalized revision. In addition, the proposed risk weights end up with higher capital needs. In view of financial stability of banking industry, transition arrangements shall be considered to avoid a sudden increase in capital requirement.
- Although not mentioned in this consultative paper specifically, BCBS's previous proposal to adopting SA capital as the **capital floor** adjusted for IRB approach shall be considered prudently. We highly suggest maintaining **sufficient incentives** for banks to develop better risk management and with healthier risk profile to avoid adverse selection by industry participants.
- Considering there are various in-process initiatives in various fields (e.g. accounting and risk management) and in various regulations (e.g. international and domestics), we urge BCBS to take the potential interaction into full consideration when proposing SA revision. We especially urge BCBS to **continue communication with IASB**. Given the similarities (common data may be shared, expected loss concept) and differences (measurement period, PIT model v.s. TTC model) between BASEL capital requirement and IFRS9 expected loss model, it might lead to not only complexity in understandings and communications amongst banks, regulators, accounting firms, investors but also causing duplications and excesses in IT investment by the banking industry.

Exposure to Banks

- 2nd consultative paper proposes to determine risk weights in Bank exposure by following either ECRA(External Credit Risk Assessment Approach) or SCRA(Standardised Credit Risk Assessment Approach), which is a welcomed direction.
- However, we have concerns regarding the Committee's current proposal to exclude government support on the usage of banks' external rating for regulatory capital purposes, except for the public banks owned by their governments. The banks external rating without government support is deemed to be fragmentary.
- It is an understandable objective to break the link between banks and their sovereigns. In the wake of the last global financial crisis, the role of the major credit rating agencies and the ratings they assign to financial institutions have come under increased scrutiny. The crisis highlighted risks that had been underestimated, while as the value of government assistance were over emphasized. However, the objective has been achieved by eliminating the option of risk-weighting bank exposures based on their sovereigns' ratings, all else is over correction.
- Since banks play a key role as financial intermediaries, they often benefit not just from the support of the parent institution – as any other firm would – but also from that of public authorities. The recent crisis illustrated that support can come in different forms: as capital injections, asset purchases or liquidity provisions. When there is a commitment to support the creditworthiness of a bank, be it explicit or implicit, the rating agency has to evaluate not only the ability of the parent or sovereign to honor this commitment but also their willingness to do so. The possibility and the magnitude of the support shall be part of the creditworthiness assessment process; no matter it is a public bank or a private bank.
- Rating agencies generally assign two different ratings to banks, a "stand-alone" and an "all-in" ratings. A stand-alone rating reflects the intrinsic financial strength of the institution and, thus, its likelihood of default, assuming that no external support is forthcoming. An all-in rating factors in the likelihood and magnitude of extraordinary external support that the bank may receive if and when it is in distress. While all-in ratings matter to banks' creditors and trading counterparties, stand-alone ratings provide useful information to a prudential authority interested in the underlying strength of institutions.
- A rating including all extraordinary support but without government support is not meaningful and is not currently available. RW calibration for bank exposures shall be reconsidered once the required rating is available. In summary, revised SA required due diligent process, it is fragmented and meaningless to require an external bank rating to exclude government support.

Exposure to Corporate

- In line with our views on Banks, we fully support the reintroduction of external ratings as a basis for risk weighting corporate exposure.

Risk Weight Suggestion to Bank and Corporate Exposure

- We further suggest BCBS to consider decreasing the risk weight for single A rated banks and triple B rated corporate, because the current risk weights under SA are over conservative. Please refer to the table below which is calculated according to IRB RW formulas (using Credit Rating Agencies published PD, LGD:45%, M:2.5Y).

	AAA	AA	A	BBB	BB	B	CCC or worse
Moody's PD [1]	14.4%	14.4%	23.6%	41.8%	95.4%	136.6%	208.2%
S&P PD [2]	14.4%	14.4%	21.9%	47.3%	91.6%	145.9%	245.2%

[1] : Annual Default Study: Corporate Default and Recovery Rates, 1920-2014

Exhibit 34: Average Cumulative Issuer-Weighted Global Default Rates by Letter Rating, 1983-2014

[2] : 2013 Annual Global Corporate Default Study And Rating Transitions,

Table 4: Descriptive Statistics on One-Year Global Default Rates

Retail Exposure

- Under current SA, regulatory retail exposures receive a single risk weight 75% which is not able to reflect risk level across banks or jurisdictions. Therefore, we appreciate BCBS's effort to explore potential risk drivers for retail exposures in the first consultative document as well as the corresponded QIS. However, in the second consultative document, BCBS turns to retain the current treatment considering undue complexity of implementation. Related studies in QIS are also removed accordingly.
- As retail exposures contain various transactions and products with different risk levels, it is not reasonable to apply single risk weight for all regulatory retail exposures. To pursue the balance between risk sensitivity and simplicity, ABA would like to suggest segmentations commonly used in retail lending practice as follows:

  (1) Differentiating payment only from financing transaction:
  Certain credit card customers use their credit cards for daily purchase and repaid credit card bills in full. These customers, i.e. credit card transactors, only use credit cards as a form of plastic money without financing activities. Therefore, lower default risk can be observed in the historical data. Further, information required to identify transactors has been embedded in most of credit card billing systems, which indicates the simplicity of this driver.

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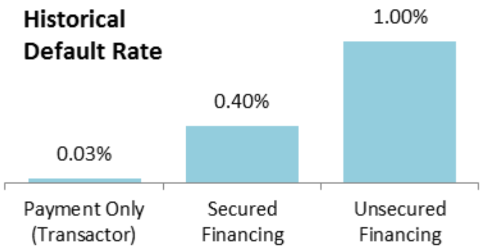
(2) <u>Differentiating secured financing from unsecured financing</u> :

Security is observed as a potential risk driver for retail exposures, and it is also a reasonable risk driver in terms of LGD. Hence, it is suggested separating secured financing from unsecured financing.

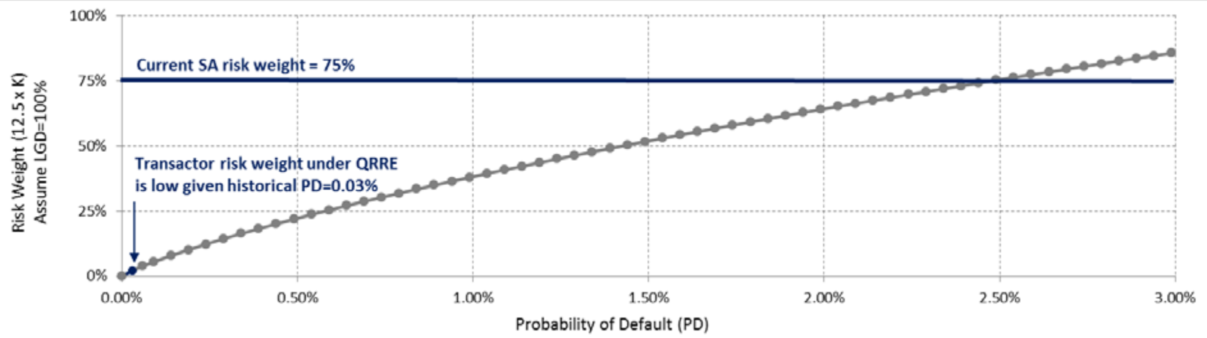
- The aforementioned segmentation is commonly used in retail lending industry. The efforts of implementation would not come from undue data collection from customers or additional operations but a clear definition of transactors and recognizable collateral types. We list down the possible definition in the table underneath for BCBS's considerations. Based on Taiwan industry data, we believe the proposed segmentation can meet both simplicity and risk sensitivity requirement.



Source: Taiwan Retail Lending Industry Data

Proposed Segmentation	Potential Definition
Payment Only	Credit card customers without revolving utilization, cash advance and interest accrued in the last consecutive 6 months
Secured financing	Vehicle loan, pledge, machinery loan, securities loan and etc.
Unsecured financing	Other loan without recognizable collateral

- The other objective of SA revision is to allow SA and IRB treatments being more comparable. Therefore, ABA performs a risk weight simulation under IRB approach following capital requirement of qualifying revolving retail exposure. The result demonstrates that a lower risk weight is more reasonable for credit card transactor. As there is no risk segmentation study for retail exposure in the QIS workbook updated in February 2016, we suggest adding the proposed segmentation in the forthcoming QIS for better assessment of its risk differentiation power and for a more risk sensitive capital requirement for retail exposures.



<u>Real Estate Exposure Class</u>

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- In the second consultative document, a new asset class is formed for real estate exposures by adding income-producing real estate (IPRE) and land acquisition, development and construction (ADC) to ordinary real estate. As there exists operational difficulty to verify whether an ordinary mortgage transfers to IPRE and vice versa during the long contractual lifetime, it is suggested identifying loan classification at origination but allowing reclassification when updated information can be obtained without undue efforts.
- In responding to the operational difficulty and comparability of DSC, the measure of payment ability is changed from DSC to qualitative items, i.e. operational requirements. We support the revision as DSC is not a comparable risk driver. Nevertheless, certain level of jurisdiction flexibility is suggested for special products. Take reverse mortgage as an example. Reverse mortgage are specially designed for elders who have home equity needs for life supports with no monthly repayment obligations. Banks are entitled to repossess the property at the end of mortgage contracts or when customers pass away. Based on the proposed definition in the second consultative document, reverse mortgage shall be categorized under IPRE with operational requirement not met as payment ability is not mandatory. It is suggested reclassifying special products according to product features subject to jurisdictions' decisions.
- The proposed risk weight for IPRE is higher than ordinary real estate to account for the higher risk expose to banks. But in view of LGD, there are no strong evidences demonstrating differences between disposing an IPRE and an ordinary real estate. The proposed risk weight treatment would require more evidence from QIS before finalization.

<u>Equity Exposure</u>

- The background and the rationale to increase the risk weight for equity exposure in not clear.
- We suggest the risk weight of equity exposure should also be based on the creditworthiness of issuers and the degree of loss. The ECRA(External Credit Risk Assessment Approach) or SCRA(Standardised Credit Risk Assessment Approach) for bank exposure and corporate exposure are also applicable to equity exposure. The degree of loss, taking the seniority into consideration, can be reflected by IRB RW formulas, using 45%, 75%, 90% LGD for senior debt, subordinated debt, and equity respectively. Based on this assumption, we believe it is appropriate to suggest equity exposures adopted a risk weight twice as high as RW of senior debt.

<u>Defaulted Exposure</u>

- We propose to maintain the link between risk weight and level of provision provided to fairly reflect Bank's provision management.

Risk weight add-on for exposures with currency mismatch

- We deem it as an unnecessary burden for banks to apply an add-on to the risk weight of the corporate exposure with a currency mismatch. It is an important function for banks to finance an operation dealing in foreign currencies to enhancement international market development. In general, hedging has been in place to manage foreign exchange risk for significant exposures. The currency mismatch, if exists, shall already be considered when granting the facility.
- It is understandable to apply a more conservative risk weight for currency mismatched retail exposures. However, there is no explicit evidence demonstrating the appropriateness of the proposed add-on risk weight of 50%. Furthermore, the risk of currency mismatch does exist not only in SA portfolios but also in IRB portfolios; the treatment shall be equivalent to avoid unnecessary implications.

Off-Balance sheet Exposure (CCF)

- The application of CCFs and their calibration is a crucial topic for off-balance sheet exposure. It is appreciated if BCBS could share the QIS results, while current BCBS proposal on CCFs does not reflect industry experience and data. It is also important to consider the linkage and alignment amongst RWA, leverage ratio, and IFRS9.
- The CCF is used as a means of estimating off-balance sheet exposures and as a proxy for the estimation of the likelihood that undrawn commitments when made available for off-balance sheet exposures will be drawn.
- We disagree with the proposal on the application of 50%-75% to all commitments (except for retail UCC), as it is over conservative. For corporate UCC (unconditional cancellable commitment), we recommend to remain 0% CCF, while the obligors' credit deterioration is identified through due diligence and post lending monitoring process and the industry experience reflects a negative CCF. For other commitments, we recommend that the CCF should be the maturity based CCF of 20% and 50%, not 50% to 75%. It is unclear why the committee feels that 50% to 75% is more appropriate than the existing 50% and 20% CCF values which distinguish between commitments less than and greater than one year in duration. The committee's current proposal penalizes off-balance sheet exposures unnecessarily.

Reintroduction of External Rating in the CRM Framework

- We welcome the reintroduction of external ratings as a basis for CRM framework.