June 22, 2016

Basel Committee on Banking Supervision
Centralbahnplatz 2, Basel, Switzerland

Re: Comments on the proposed to
"Reducing variation in credit risk-weighted assets － constraints on the use of internal model approaches"

Dear Sirs and Madams,

On behalf of Asian Bankers Association, we would like to express our earnest appreciations and to deliver our comments on the Basel Committee on Banking Supervision's (BCBS) proposal on "Reducing variation in credit risk-weighted assets － constraints on the use of internal model approaches" (the 'proposal').

We recognized the importance of the revision and acknowledged the challenges the work will face. The Association and our members are ready to collaborate with BCBS 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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Comments on BCBS D362:

Reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches

ABA (Asian Bankers Association)
2016 June

General Comments

- We understand this consultative paper *"D362 Reducing variation in credit risk-weighted assets - constraints on the use of internal model approaches"* is part of "Basel III" measurement reform set. One of the main objectives of "Basel III" is to improve risk management and governance. We are seeing the convergence of Internal Rating Based Approach (IRB) and Standardised Approach (SA).
- The variation between Standardized Approach and Internal Model Approach, and the variation amongst banks' risk weighted asset (RWA) results reflect the capability difference on risk management and risk measurement. In this case, we believe only the "excessive variation" shall be removed. Appropriate variation, providing bank good incentive to continue develop comprehensive risk measurement, improving the banking sector's ability to absorb shocks arising from financial and economic stress, improving risk management and governance, shall remain.
- We have provided the following comments to BCBS d347: ***Revisions to the Standardised Approach for credit risk,*** and we deem it is especially important. 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.

Capital Floor

- We believe current proposal is **over conservative** and creates unnecessary difficulty for banks to adopt IRB, while the proposal introducing the floors to PDs and LGDs parameters and applying an overall capital floor based on standardized approach concurrently. 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.

- If BCBS still deems floor on parameter level as necessary, we suggest to take loan-to-value (LTV) into consideration when determine LGD floor for secured exposure. One size fit all floor penalizes the exposure taken appropriate credit mitigation.

<u>Parameter estimation practices</u>

- Section 4 sets out the Basel Committee's proposals to limit the range of practices regarding the estimation of model parameter under the IRB approaches. These proposals aim to reduce unwarranted variability in RWA and to simplify the credit risk framework. However, a few proposals seem over conservative and unnecessary. Examples are as below:
    - Section 4.4.1: "Data used to calculate PDs", it requires a **minimum weighting of data from downtown years of one in ten**.
    - Section 4.2.3,Banks must separately estimate for non-defaulted assets:(i) a long-run average LGD for each exposure; and (ii) **an add-on to reflect the impact of downturn conditions**.

  While current requirement already adopts full business cycle and include downturn conditions, there is no need to create unnecessary complexity and conservatives.
- One of the main sources of practice-based RWA variation in BCBS d363: ***RCAP-Analysis of risk weighted assets for credit risk in the banking book*** is the wildly varying interpretations of the IRB regulation, such as long-run average, business cycle, and downturn definition. To reduce the IRB RWA variability among banks, BCBS should delineate clear definition of the regulation rather than simply set up the thresholds for all IRB banks

<u>Off-Balance sheet Exposure (CCF)</u>

While lots of CCF under IRB approach refers to Standardised Approach, hereby we restate our comments to ***BCBS d347: Revisions to the Standardised Approach for credit risk***.

- 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 (including undrawn revolving and non-revolving commitment), 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.