Bangkok Bank

March 27, 2015

Mr. William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel
Switzerland

Re : Comments on the BCBS consultative documents on *Revision to the Standardized Approach on Credit Risk* and *Capital Floor : the design of a framework based on Standardised Approaches*

Dear Secretary General Coen,

Bangkok Bank PCL, ("the Bank") appreciates this opportunity to comment on the December 2014 Consultative Document issued by the Basel Committee on Banking Supervision ("the Committee"), Revision to the Standardized Approach on Credit Risk and Capital Floors: the design of a framework based on standardized approaches ("Consultation Papers").

The Bank appreciates and fully supports the Committee in reviewing the regulatory capital framework and the shortcomings of internal model practice. However, we are of the opinion that such efforts should not result in overhauling Basel III and its underlying standards. The whole industry together with the Committee had put so much time and efforts in institutionalizing new capital standards. This includes capital buffers, more stringent definition of capital as well as the leverage ratio and liquidity ratios. All of which are on the verge of full implementation by banks, supervisors and regulators across the globe at significant cost and efforts. It is deemed unnecessary to destabilize and to halt such process with the new proposed standards such as this revision to standardized approach on credit ("SA credit") or the new capital floor. Both of which will require tremendous efforts in adjusting existing IT process and collecting required data. There are other methods that the Committee can address such shortcomings or inconsistent practices being used by certain participants. This can be done through the usage of RCAP process. RCAP process will provide direct information or inputs to regulators and authorities on improper practices such as regulatory arbitrage through internal models. Once issues are identified, local supervisor can exercise its power through Pillar II and Pillar III requirements on specific banks in order to address issues of concern.

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The Committee should also recognize that there are a number of regulations and guidelines that are gradually phasing in or even under observation period. Combined effect of these measures remains largely unknown. Introducing additional dramatic change might make the impact evaluation on bank's capital, portfolio and business model as well as general economy become challenging at the end. The ramification, if any, will be harder to analyze and the development of rectification will become more difficult.

The bank also observes that there are still missing parts with regards to 'risk sensitivity' in the presently issued consultation papers. Therefore, we are concerned that the Committee might dissociate the capital and true risk profile of individual institutions. The assumption that higher capital will contribute to greater resilience of the bank may not be entirely accurate and should never be established without looking at the real portfolio and real risk that the bank is exposed to. In addition, certain factors that substantially affect the risk profile such as taxes, accounting and legal regimes, product features, portfolio segment, and market-specific mitigating factors can be extremely different by jurisdiction. These differences are likely to hinder the original intention to narrow the capital number produced by SA and internal model approaches. The discrepancies between SA credit and internal model may be end up widening.

The review should also analyze possible impact on the financial stability of the banking sector in the bank-based economies where their prime duty is to provide credit and relevant financial services to the real economy. These financial markets, mostly in emerging market economies, still lack of sufficiently-developed and adequately deep capital market. Participants in these markets rely primarily on banking sector to perform the tasks of providing financing alternatives. The Bank is concerned that the combination of SA credit, the capital floor as well as the leverage ratio introduced earlier may make the low risk portfolios such as mortgage loan, credit card, SMEs as well as certain investment grade portfolio economically unviable. This is largely because returns will no longer commensurate with the regulatory cost. This may cause banks to constrain its lending to these sectors, causing financial and economic chaos as well as pushing customers toward the shadow banking sector where no such controls exist.

With regards to the proposed revision on SA credit, the Bank is concerned with regards to a perceived lack of risk sensitivity issue as well as the overall impacts of the standard as per following detail:

- The elimination of external credit ratings in the proposed consultative document does not provide sufficient information about the rationale behind the selection of new risk drives and the linkage between those drivers and proposed risk weight. In addition, risk drivers especially those extracted from financial statements may be different from one jurisdiction to another due the variation in taxes and accounting standard. Moreover, capital requirements will disproportionately increase for good quality portfolios and short term exposures as the proposal presents little differentiation among investment grade classes. Also, the use of the CET1 ratio as a risk driver of bank assumes that definitions and capital approaches of all banks are consistent, which may not be the case.

- The proposed methodology with limited classifications granularity will certainly lead to another unintended consequences in emerging economies as it would penalizes SMEs which are, from the new proposed standard, reclassified from Retail asset class to corporate asset class with relatively higher risk weights than large corporates. This totally ignores SMEs' portfolio diversification nature. It should be understood that financial statements in emerging market, prepared by SMEs in particular, might not reflect true financial health and business activities of SMEs as those financial statements were developed primarily for tax purposes. Emerging market banks, in practice, must rely on internal reconstruction of customers' financial statements as well as other external factors, including collaterals, to reflect more accurate overall risk profile of SMEs. This may not be the same practices used by banks in more developed market. Adopting the new proposal is likely to undermine the economic growth of emerging countries where SMEs and investment in infrastructure are prevalent.
- Moreover, higher credit conversion factor applied to uncommitted credit line will have a direct impact on companies in bank-based economies. Companies in bank-based economies have more limited funding options when compared to those in more developed markets. This degree of impact is generally more severe in the case of SMEs in bank-based economies as large corporates may be able to access to capital market. The proposed new guidelines will undeniably incentivize banks to reduce or eliminate such liquidity supplementary mechanism (working capital credit lines), or to pass on these additional cost to customers. This results in increasing credit cost to both SMEs and corporates and this could possibly drives them to shadow banking sector as well.
- The bank supports the Committee's general ideas of using the planned QIS exercise to prudently justify its final decision. However, we note that there are numerous limitations in QIS, for example, data setup in certain banks may not be promptly available for the calculation under the proposed guideline. As a result, to ensure quality of data and QIS itself, certain period of time is required to develop IT infrastructure to extract required information. In addition, it is also vital that QIS instructions, questions and answer sessions (FAQs) are publicly available for uniform interpretation and usage. Without such pre-requisite, the bank would not be able to provide valid and concrete comments nor can they provide reliable information required from the existing QIS format. Eventually,

the Committee may end up drawing an unjustifiable conclusion using such numerous assumptions or proxy information and comments.

- It is also noted that, while the Committee tries to promote greater risk sensitivity in new SA credit, the Committee did the opposite in the new SA on operational risk. The new SA on operational risk uses 'size' as a primary driver without taking into consideration operational risk management being practiced by banks.

With regards to the proposed SA Capital floor, the Bank is concerned that capital floors proposed are inconsistent with the aims of risk sensitivity, simplicity and comparability.

- Capital floors will be in conflict with one of the Committee's original objectives: to promote more advanced practices in risk quantification and, consequently, enable the banks to assess and price risk more accurately to balance risk and returns. Introducing such capital floor would blur this objective as well as would materially affect the banks particularly in their pricing determination. Capital floors may cause the pricing to be the reflection of cost of capital rather than the reflection of the underlying risk of clienteles. In addition, the Bank's view is that internal models incentivize that bank to better reflect the bank's risk profile and is a major tool to promote better risk management and government processes. We are convinced that this will ultimately increase the resilience of the banking system.
- Capital floors have the potential to compromise the goals of simplicity and comparability as such concept fails to recognize the quality of a bank's internal risk management. As mentioned above, key parameters the banks use internally to manage its risk may be overlooked. In addition, each bank has its own underwriting standard and ratios that are likely be different depending upon its culture, legal regimes and accounting standard.
- Regulatory capital framework is supposed to focus on the appropriate level of capital that individual bank should maintain. Adequate capitalization at industry level will be realized as a consequence. So, the Bank believes that the Committee should pay attention to proper capitalization at an individual level rather than concentrating on industry capitalization. This is because sufficient industry capitalization does not translate to the resilience of banking industry. In addition, certain undercapitalized banks may not be properly supervised or managed due to the illusion of sufficient capital at the aggregate level.

Based on the above comments and recommendations, the Bank would like to conclude with the following proposal:-

- Keep the current version of Basel III and allow all components of Basel III to completely phase in while using Pillar II and Pillar III as well as RCAP to address any capital shortfall or misconducts. Then, evaluate the consequences of Basel III implementation and make necessary adjustments.

- Once banks around the world fully adopt Basel III and all the consequences are properly addressed, the Committee can go ahead with the further refinement of Standardized Approach to credit. The Committee is encouraged to establish clear and realistic timeline.
- The Committee should be mindful of the challenge and readiness of each market particularly the bank based economy versus market based economy and impact of one-size-fit-all to those market.
- The Committee should urgently publish QIS instructions and FAQs and make available before the reporting date of the QIS to ensure adequate quality of the information provided by the participating banks.
- The Committee should defer the QIS exercise to later date allowing enough time for participating banks to understand and prepare the best necessary data available and, if possible, to request the QIS in phase based on its priority and best guess of industry's readiness to provide such data.
- Provide second consultative paper once the necessary information and data are properly evaluated and postpone the implementation of Capital Floor until all relevant information becomes clear and all intended and unintended consequences are assessed.

For your kind consideration.

Ayuth Krishnamara
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Head of Risk Management Division
Bangkok Bank PCL