Revisions to Standardized Approach for Credit Risk BCBS D307

Bank Alkhair Feedback on the Proposed Changes

Bank Al Khair review and feedback to BCBS Consultation paper which proposes material changes to the calculation of Capital Adequacy Ratio with risk-weighted of certain assets which will have impact on banks exposures.

Proposed change	Feedback
Reduce reliance on external Credit Rating agencies.	• The matter arises due to governance and conflict of interest issues with external assessors such as ECAIs and external auditors. As the analysis required to properly measures risk weights is complex by nature, we would recommend focusing on ways to mitigate such conflicts (e.g. regulatory reviews & categorization of assessors). • As and when the above is addressed, smaller credit rating agencies would be well positioned to independently rate SMEs and other entities not rated by ECAIs. • Standardizing will not prevent herd behavior, and accumulation of credits poor prospects that rate well under the proposed methodology towards non-IRB banks.
For Bank exposures: • Would be based on two risk drivers: the bank's capital adequacy (CET1) and its asset quality (NNPL Ratio). • RWs would range from 30% (CET1=>12% and NNPA<=1%) to 140% (CET1 at 4.5%-5.5% and NNPA>3%), with a 300% RW for CET1<4.5% or with necessary data not being disclosed according to Pillar 3 requirements	• There are many other factors (besides capital adequacy and asset quality) which determine the credit risk like funding profile/stability, liquidity, earnings quality, management quality, shareholder support, systemic support etc, which do not find a mention. • Notably, crisis years showed banks' high vulnerability to liquidity and funding shortages – especially those banks with significant levels of market funding (notably short-term). • Some banks do not publish CET 1 and NNPL ratio in quarterly financials. Basing the RW on old data may be inaccurate, considering metrics for some banks (esp. wholesale banks) change quite quickly. • A one-off change in CET 1 to below 4.5%, can result in 300% weightage. • For exposure to an investment bank with a good CET1, small loan book but large equity exposure, RW will be lower because of low NNPL, which will potentially undermine actual risks of such an exposure. • NPLs: Lack of restrictions on ever-greening/restructuring loans without classifying as NPAs. • Lack of uniformity and incentives to measure and report NNPA. It also does not include non-interest bearing exposures. • Tier 1 ratio should be sufficient as AT1 provides high coverage. • Need to separate Wholesale from Retail criteria, and in particular exposures by asset type. • Short term claims: LCR ratio should form the basis for a reduced risk weighting. • The committee use CET1 as a risk driver for the banks to assign the appropriate RW, but how about the Banks which

	they incorporated where the Basel III is not yet implemented. What is the other option? Suggest total tier 1 as a base instead. • Why the committee kept the sovereign exposures risk Wight unchanged and still depend on the external rating?
For corporate debt exposure • Would be based on two risk drivers: company's revenue and leverage. • Based on these metrics RWs would range from 60% (revenues>EUR 1bn and leverage at 1x-3x) to 130% (revenues<=EUR 5m and leverage>5x), with a 300% RW for corporates displaying negative equity.	• There are many other factors which determine the credit risk of a company like industry outlook, competitive position, profitability, liquidity profile, debt service coverage, lack of forward looking emphasis, etc. By basing ourselves on only revenue and leverage, we are not sufficiently capturing credit risks and can potentially open doors for gaming the system. • Proposed drivers are more sensitive to economic cycles (compared to credit ratings which are relatively stable) and therefore can increase volatility of RWAs. This will have a particular impact on banks having portfolios largely consisting of unrated borrowers. • Timely data availability will be crucial as the BCBS proposes to apply a risk weight of 300% in cases where the required data are not available • Some RWs need a better calibration across credit sectors. As one example, a large bank with an acceptable capital ratio (e.g., CET1 of 9.4%) and slightly below-average asset quality (e.g., NNPA of 3.1%, which is quite acceptable in the region) would obtain the same RW (100%) as a small leveraged SME (e.g., EUR 3m and 2.9x leverage). • Overall, the proposed new risk weights look higher on average than under the current standardized approach – in particular the proposed range of risk weights for corporates of 60 - 300% is considerably higher than the current range of 20 – 150% • Treatment of non-startup companies without recent audited financials should attract the highest risk weighting. Similarly, all companies should be audited by audit firms of a size and standing that is commensurate with their clients' size (by revenues and/or assets).
For equity exposure • For listed equity – 300% and unlisted equity 400% RW	• This will have significant effect on investment banks which have a large equity exposure and are currently weighing it at 100% for listed and 150% for unlisted equity. • The higher Equity RW unfairly impacts banks that carefully invest in low risk equities.