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Secretariat of the Basel Committee
on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Doc Ref: #174344v1

Your ref: 2nd consultative document "Revisions to the Standardised Approach for Credit Risk"

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Dear Sir / Madam

Revisions to the Standardised Approach for credit risk

The Banking Association of South Africa ("BASA") appreciates this opportunity to comment on the Basel Committee on Banking Supervision (BCBS) 2nd consultative document "Revisions to the Standardised Approach for Credit Risk" which forms part of the Committee's broader review of the capital framework to balance simplicity and risk sensitivity, and to promote comparability by reducing variability in risk-weighted assets across banks and jurisdictions.

We would like to thank the Committee for considering industry concerns relating to the limitations of removing all references to external ratings as proposed in the first consultative document and we support the revised proposal to use external ratings as part of the risk determination for certain exposures.

Given the intention to use the revised standardised framework as a basis for capital floors, we emphasize the importance of completing an in-depth analysis to assess the appropriateness of the calibrations included in the proposal and thus we support the upcoming Basel monitoring exercise that will include QIS on credit risk.

The inherent difficulty of developing a new framework for a Standardised Approach to Credit Risk is that there are so many moving parts to its calibration i.e. changing one aspect of the methodology influences other frameworks as well. As such, we implore the Committee to conduct a holistic assessment of these interactions needs to be undertaken with the industry before any reforms are finalised.

Our response to the Committee's specific questions has been captured on *Annexure A*;

We thank you for taking our comments into consideration, and we look forward to future discussions on these issues.

Yours sincerely

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Gary Haylett
General Manager – Prudential

ANNEXURE A

BCBS 2nd Proposal	BASA Comment
Bank Exposure	
In jurisdictions that do not allow the use of ratings for regulatory purposes (and for unrated exposures in all jurisdictions), banks would classify exposures into three different buckets (A, B and C) provided that certain minimum criteria are met. Due diligence could also result in the classification of an exposure into a higher-risk grade even if the minimum criteria of a lower risk grade are met - Standardised Credit Risk Assessment Approach (SCRA)	• The wording used under the proposal for SCRA, the requirement for Grade A classification i.e. counterparties that have "adequate capacity to meet their financial commitments (including repayments of principal and interest) in a timely manner, for the projected life of the assets or exposures and irrespective of the economic cycles and business conditions and exceed the published minimum regulatory requirements and buffers"; could be open to interpretation. - For improved comparability we suggest clearer guidance be provided on what would be deemed as "*adequate capacity*" • Regulation requires that banks cap their external ratings at those of their sovereigns. The external sovereign rating for many emerging market economies is below investment grade. Under the new proposal, to the extent that a bank that has "adequate capacity" but is in a jurisdiction that allows the use of external ratings would have its ratings capped at the sovereign's below investment status (RW: 100 - 150%). - This will disadvantage jurisdictions that must apply the external rating methodology relative to jurisdictions that don't i.e. in a jurisdiction that does not allow external ratings a

<table>
<tr><th>BCBS 2nd Proposal</th><th>BASA Comment</th></tr>
<tr><td></td><td>similar bank meeting the above requirements in terms of adequate capacity to repay, minimum regulatory requirements and buffers could be rated Grade A (RW:50%) as there is no cap applied. This seems misaligned</td></tr>
<tr><td colspan="2">Corporate Exposure</td></tr>
<tr><td>In jurisdictions that allow the use of ratings for regulatory purposes, ratings would be the primary basis to determine risk weights for rated exposures.

<table>
<tr><th>External rating of counterparty</th><th>AAA to AA-</th><th>A+ to A-</th><th>BBB+ to BBB-</th><th>BB+ to BB-</th></tr>
<tr><td>"Base" risk weight</td><td>20%</td><td>50%</td><td>100%</td><td>100%</td></tr>
</table>
</td><td>
In jurisdictions that use of ratings for regulatory purposes, consideration should be given to the risk weight of a BBB corporate exposure. The risk weight of BBB (i.e., investment grade) corporate exposure is proposed at 100%, which is the same as BB (i.e., non-investment grade).
- As BBB is likely to have better credit quality than BB, we propose that the risk weight for BBB corporate exposure be revised to 75% in order to apply a more risk sensitive framework by differentiating between the external rating bands
- Perhaps banks should perform independent internal due diligence analysis and not solely rely on agency ratings for credit decision-making purposes
</td></tr>
<tr><td colspan="2">Retail Exposure</td></tr>
<tr><td>Regulatory retail: retail exposures will be risk-weighted at 75%, unless the exposure is defaulted</td><td>
The flat risk-weight of 75% for regulatory retail exposures should be revisited as we consider such a risk-weight punitive for good quality portfolios.
- We recommend that a range of commonly recognised risk characteristics be established that
</td></tr>
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BCBS 2nd Proposal	BASA Comment
	identify lower-risk retail credit exposures.
Other retail: exposures will be risk-weighted at 100%, unless secured by real estate	• The risk sensitivity of regulatory retail exposures such as vehicle financing could be increased by considering standard risk drivers such as proportion of loan repaid, product type etc.
Exposures Secured by Residential Real Estate	
The LTV ratio is the amount of the loan divided by the value of the property. The value of the property will be maintained at the value measured at origination unless national supervisors elect to require banks to revise the property value downward	• In terms of the calculation of LTV keeping the value of the property constant as at origination may be inaccurate and the proposed capital requirement would be overly conservative, particularly in emerging markets with strong growth in real estate market valuations
When the prospects for repayment and recovery on the exposure materially depend on the cash flows generated by the property securing the loan rather than on the underlying capacity of the borrower to repay the debt from other source exposure will be risk-weighted between 70% - 120%	• To ensure greater consistency, comparability, and applicability on both a national and international basis it would be clearer from an implementation perspective if a materiality threshold were specified for both Residential and Commercial real estate • Under the current Standardised Approach the RW for all exposures secured by mortgages on residential property is currently 35%. We are concerned about the proposed level of increase in capital requirements for residential mortgages where 'repayments are materially dependent on cash flows generated

<table>
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<tr><td></td><td>by the property' i.e. IPRE to 70% - 120%.
- In some emerging markets the majority of urban market employees source housing through rentals. The higher capital requirements could have negative consequential effect on the socio-economic objective of improving housing availability.
- We suggest including conditions which, if met, would allow the use of the lower regular mortgage risk weights for high quality IPRE lending.
• We also note that unsecured retail exposures are risk-weighted at 75%, however, secured loans for Buy-to-Let with an LTV of 80% are risk-weighted at 90%, which does seem counterintuitive</td></tr>
<tr><td colspan="2">Risk weight add-on for exposures with currency mismatch</td></tr>
<tr><td>Banks would apply a 50% risk weight add-on to "unhedged exposures" with currency mismatch, where "unhedged exposure" is defined as an exposure to a borrower that has no natural or financial hedge against the foreign exchange risk arising from the currency mismatch</td><td>• In a number of jurisdictions, it is common practice for the lending currency to differ from the currency of the borrower's main source of income where that income is effectively indexed to the lending currency (though collected in the local currency). It would therefore be an overly conservative assessment of the risk profile if a 50% add-on were applied.
- We believe requiring currency mismatch add-on for corporates is not appropriate. Such risk is already incorporated in the external rating and is supported by the bank's own credit assessment and due diligence.</td></tr>
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	- It is proposed that the add-on only be applied if an effective hedge cannot be demonstrated