

**BPIFrance response
to the Basel consultation on revisions to the Standardised Approach for credit risk**

Bpifrance is a French public bank whose mission is to finance SME and innovation. It is active in three main business lines that have a common objective of working with entrepreneurs and SMEs during the riskiest phases of their projects, from the company's creation through to its transfer / buy-out, and including its innovation and international expansion:

- Innovation support, support and financing for innovative projects that have concrete prospects of completion;
- Investment and operational cycle financing alongside banking institutions;
- Bank financing guarantees and the involvement of equity investors.

As of 31 December 2014, BPI innovation aid accounts for EUR 0.9 billion, the amount of guaranteed risks for EUR 3.7 billion, investment co-financing for EUR 5.8 billion, mobilisation of receivables for EUR 3.6 billion, and pre-financing of the CICE¹ for EUR 2.4 billion.

The Basel Committee proposed in "Revisions to the Standardised Approach for credit risk", published in December 2015 a new method to risk weight SMEs under the Standardised Approach of the Basel framework, as well as a new method to rate banks, both detrimental to SME funding.

I. A risk sensitive rating table to determine risk weights for SMEs should be kept

The new method proposed by the Basel Committee encompasses some positive changes compared to the first draft of proposals of March 2015. For instance, we support the distinction between exposures to large corporates and SMEs², aligning the definition of the SME portfolio of the Standardised Approach to the one used under the IRB approaches. However, the proposition of the Basel Committee to apply for SMEs a constant 85% risk weight that does not rely on ECAI ratings results in an approach for SMEs not sensitive to risk. On the contrary, this is positive that mid-cap companies keep a risk weight based on external ratings, with due diligence by the bank to have a higher risk weight should the risk analysis reveal any fragilities of the company.

Back to SMEs, most French SMEs are rated by "FIBEN" (Fichier bancaire des entreprises), an External Credit Assessment Institution's rating system provided by the Banque de France and a reliable source of risk sensitive information. The Banque de France is the French central bank and is independent from political pressures. This is not a private credit rating agency and there is as a consequence no possible conflict of interests between the Banque de France and the counterparties rated. FIBEN is a reference for the French banking industry. The companies that are rated by FIBEN are assessed regarding their capacity to meet their financial commitments through a time horizon of 3 years. The scope of companies comprise all corporates, associations and civil societies, and all natural and legal persons whose registered office or domicile is in France.

¹ Crédit d'impôt Compétitivité Emploi. This gives companies with low labour costs a tax advantage.

² "It is proposed to apply the same definition of SME that is used in the IRB approach to distinguish SMEs from large firms in the corporate portfolio, i.e. entities where the reported sales of the consolidated group of which the firm is a part are less to EUR 50 million (see Basel II, paragraph 273)", "Revisions to the Standardised Approach for credit risk", December 2015.

Applying a constant 85% risk weight is particularly detrimental for top credit quality SMEs and good quality SMEs, respectively currently weighted at 20% and 50% based on the FIBEN ratings. The capital is multiplied respectively by 4.25 and by 1.7. A survey by BPIFrance found that the Basel II standardised risk weights for SME lending are at 77%. Thus, an 85% risk weight represents an increase in capital by more than 10%.

This constant risk weight is furthermore in contradiction with the political line of the European Banking Authority (EBA), whose one of the recommendations to promote SME lending is to widespread the use of ratings for SMEs through the European Union (EU) : “Promoting the use of consistent ratings across SMEs in the EU could have a beneficial effect on their access to finance, as good-rated SME included in the Corporate asset class could directly benefit from lower capital requirements”³. Remove the ratings to attribute SME risk weights would thus be damaging to SME funding, to banks that specialise in SMEs financing and to the viability of their business model.

To fulfil the Basel Committee’s objective that “*capital requirements [...] be commensurate with the underlying risk*”, we thus support a risk sensitive rating table for SMEs, based on ECAIs rating and why not risk drivers, with lower risk weights than for large corporates in order to reflect that SMEs have a lower risk correlation than large corporates and often benefit from collateral not recognised under the Standardised Approach⁴. Another solution would be to set a lower risk sensitive rating table and to recognise physical collateral under the Standardised Approach.

II. The Basel Committee should maintain the link to sovereign ratings for promotional banks owned by public authorities, where banks are incorporated in jurisdictions that allow the use of external ratings for regulatory purposes

Where banks are incorporated in jurisdictions that allow the use of external ratings for regulatory purposes, the Basel Committee’s proposal implies a 50% risk weight (grade A) for very good unrated public banks. Similarly, where banks are incorporated in jurisdictions that do not allow the use of external ratings for regulatory purposes, a 50% risk weight (grade A) will be applied for very good public banks.

Promotional banks owned by public authorities provide many SME loans originated by private banks with their guarantee. Some of these promotional banks are unrated banks, owned by their national or local government and thus benefiting from its explicit government support. Applying a 50% risk weight to such banks is detrimental to the guarantees provided by them to SME lending and will be damageable for SME funding. A lower risk weight should be applied.

The current Basel II treatment under the Standardised Approach relies on the use of the sovereign rating to risk weight banks, with a specific risk weight table. To reflect the trend to suppress the implicit government support to banks, such a link has been suppressed in the Basel Committee’s proposals. We nevertheless support the upholding of this link for unrated promotional banks owned by public authorities, where banks are incorporated in jurisdictions that allow the use of external ratings for regulatory purposes. The sovereign rating should be used to determine the risk weight of the unrated bank, and the “base” risk weight associated according to the new table by the External Credit Risk Assessment Approach (ECRA) should apply. Banks should furthermore perform due diligence to ensure that the external rating appropriately and conservatively reflect the creditworthiness of the public bank considered. Due diligence analysis should never result in the application of a lower risk weight than that determined by the external rating.

³ “Assessment of SME proposals for CRD IV/CRR”, EBA, September 2012.

⁴ As written in “Revisions to the Standardised Approach for credit risk”, December 2015, “*SMEs typically provide more physical collateral than other large corporates. This collateral, despite not being recognised under the SA’s credit risk mitigation framework, may offer protection against credit losses and result in lower average losses given default compared to other large corporate exposures*”.