President

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Black Sea Trade & Development Bank

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Your Excellencies,

I would like to begin by expressing my best wishes to you and yours. It has been a while since we have had the opportunity to meet, dating back to when I was Vice Chairman of the Banking Regulation and Supervision Agency of Turkey, which I represented at the Basel Committee on Banking Supervision (BCBS).

Today, I have the honor to contact you as President of the Black Sea Trade and Development Bank (BSTDB), a multilateral development bank (MDB) devoted to the promotion of economic development and regional cooperation in the greater Black Sea region.

By way of this letter, I would like to take the opportunity to provide some feedback to the Consultative Document of the BCBS *Revisions to the Standardised Approach to Credit Risk* that was posted on the BCBS website in December 2014. We intend to upload the comments on the webpage created for this purpose by BCBS, but I wanted to bring the issues to your attention personally.

First of all, we strongly support the intention of BCBS to introduce a new subcategory of "Qualifying MDBs" that is assigned a risk weight based on the MDB's external credit rating, subject to the fulfillment of certain conditions. It (i) represents a major step towards addressing the issue of MDBs more thoroughly, (ii) it recognizes legitimate MDBs as a distinct category, and (iii) it lays out clear criteria for the determination of what a legitimate MDB is, something which will surely be very helpful for MDBs and for those who interact with them- their sovereign shareholders, investors, credit rating agencies, regulatory bodies, other international institutions and forums, etc.

There has been a 'gap' in the marketplace in terms of how MDBs are perceived and treated, and this proposed revision represents important progress, by addressing the issue in a

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practical manner that properly recognizes their supranational character. Significantly, it also removes the conflation of the structural nature of an institution and its level of credit risk that appears in the existing basis for the definition of an MDB, namely Paragraph 59 of the BCBS paper *International Convergence of Capital Measurement and Capital Standards: A Revised Framework Comprehensive Version*, issued in June 2006.

Turning to the details laid out in Part 3 of Annex 1 on 'Exposures to MDBs' of *Revisions to the Standardised Approach to Credit Risk*, we are in full agreement with the very appropriate criteria (iii), (iv), and (v) of Paragraph 11a, which determine what constitutes a "Qualifying MDB". As regards criteria (i) and (ii) of Paragraph 11a, we understand the underlying rationale, yet, based on our suggestion below, we would like to posit that their inclusion may ultimately not be necessary.

More specifically, the table in Annex 1 Part 3 Paragraph 11b treats "Qualifying MDBs" in a manner akin to "non-central Government public sector entities" in the table in Annex 1 Paragraph 8 Part 2 Option 2. Since this table provides for a lowest risk weighting of 20% for Qualifying MDBs rated from AAA to AA-, it creates a need for the elaboration of a separate category of "Highly Rated MDBs", the inclusion of criteria (i) and (ii) in Paragraph 11a, and the clarification that the Committee will evaluate eligibility on a case by case basis.

Our suggestion would be BCBS to give consideration to the treatment of MDBs in a manner similar to that outlined in the table in Annex 1 Part 1 Paragraph 4 on 'Exposures to Sovereigns'.

It would treat all legitimate MDBs in a consistent manner along an easy to understand and transparent continuum, allowing for risk weights to be assigned according to their external credit rating. The MDBs included under "Highly Rated MDBs" would continue to receive a 0% risk weight because of their characteristics, and it is well known that credit rating agencies put significant weight already on the criteria mentioned in (i) and (ii) in Paragraph 11a. Thus, and as mentioned above, this would effectively remove the need for the separate mention of criteria (i) and (ii) in Paragraph 11a, and MDBs could rise or slide according to these ratings, without requiring the extra step of special consideration of eligibility (or removal thereof).

Moreover, we believe that there is a strong justification to treat MDBs along the lines of "sovereigns" as on Annex 1, Part 1, Paragraph 4, than as "non-central Government public sector entities".

Empirically, MDBs have proven to be safer than sovereigns, and there is no record of default by an MDB that fulfills criteria (iii), (iv), and (v). MDBs are very public institutions which normally follow standards of transparency and reporting that exceed those of sovereigns, and tend to be far more prudent in their lending requirements and conservative in their financial policies.

MDBs are effectively supra-sovereign, owned by multiple sovereigns. Their credit ratings are generally either equal to or better than the credit ratings of their sovereign shareholders. This applies to both AAA MDBs as well as sub-AAA rated MDBs that would fall into the "Qualifyng MDBs" category.

In addition, the differentiation of highly rated MDBs and Qualifying MDBs retains an element of subjectivity (e.g. the evaluation of eligibility on a case by case basis for the former) which could be removed by applying risk weights according to one table- such as the one in Annex 1, Part 1, Paragraph 4 (or perhaps slightly adjusted).

One final point which we would like to bring to the attention of BCBS for consideration is that, at present, certain regulatory authorities of countries that are shareholders of institutions that would be classified as Qualifying MDBs, currently apply low or zero risk weights to those MDBs on a case by case basis. Their rationale for doing so is that they know the MDB in depth including its ontology, immunities, sovereign shareholding, prudent collective governance, high capitalization, conservative financial policies and concentration limits and ability to fulfill its mandate. For such cases, **we would propose that BCBS consider making express allowance in the final text of the revisions for such pre-existing and future cases, where the sovereign shareholders of an institution may choose to apply zero risk weights to MDBs on a case by case basis, since they possess extensive and thorough knowledge of the quality of an institution and its track record, and can thus make a well informed decision.**

We thank you for your time and interest in this matter, and once again, we would like to congratulate BCBS on the issuance of the Consultative Document *Revisions to the Standardised Approach to Credit Risk,* as it represents a significant step forward in many respects, including the categorization of MDBs. Please do not hesitate to contact me if you have any comments, and, at your convenience, we would be happy to discuss the issue further or to provide additional supporting information and information, particularly as regards BSTDB.

Sincerely yours,

Ihsan Ugur Delikanli
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