

BIS 86-008855
26.02.16

President

February 25, 2016

Mr. William Coen
Secretary General of the Basel Committee on Banking Supervision
Basel Committee on Banking Supervision

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Your Excellency,

I hope this second letter of mine finds you well. It is no secret that the Basel Committee on Banking Supervision (BCBS) is going through a particularly busy period, given global uncertainties and developments in financial markets. I must therefore express admiration at the important work which BCBS continues to produce, while managing to continue its inclusive processes of external consultation, which permit feedback.

In this spirit, I would like to take the opportunity to offer some commentary on the second consultative document on *Revisions to the Standardised Approach for credit risk that was posted on the BCBS website on 10 December 2015. To a degree, this commentary represents a reiteration of the proposal made in my first letter to BCBS on 20 March 2015 (attached for easy reference), which was posted as feedback for the initial consultative document on Revisions to the Standardised Approach for credit risk.*

Indeed, having examined the history of MDBs over the years, we are inclined to recommend a 0% weighting for all bona fide MDBs, including BSTDB. **From the list of highly rated MDBs, it is evident that it is possible to obtain a 0% risk weighting without having a AAA rating so long as an MDB meets certain key requirements. In this respect, other than our long term issuer ratings (currently A2/ A-), we fulfill most of the eligibility criteria for an MDB listed in Annex 1 Part 3 Paragraph 11b including: the portion of point (ii) which states that “the majority of the MDB’s fund-raising is in the form of paid-in equity/capital and there is little or no leverage”, point (iii) about strong shareholder support, as demonstrated by the amount of paid-in and callable capital (and the ratio between the two), point (iv) about adequate levels of capital and liquidity and point (v) about strict statutory lending requirements and conservative financial policies, concomitant with high levels of transparency and quality of**

governance¹. Furthermore, there is the very important historical track record of no MDB ever having defaulted- something which demonstrably makes them safer than sovereigns. However, we realize that this would represent a departure from the practice of recent years, and in view of the focus on credit ratings and having AAA rated shareholders in earlier definitions of MDBs, may come across as too radical a change to consider.

Therefore, we would like to reiterate the proposal in our letter of 20 March 2015 that bona fide MDBs should, under the standardized approach, be treated in a manner akin to that envisioned for sovereigns in Annex 1 Section A.1 Paragraph 4. Our proposal takes a more gradualist approach and puts MDBs along an established continuum already in place for sovereigns. As such, we continue to sincerely believe that it offers an elegant, robust, objective framework for calibration of risk exposures.

In addition, it averts a potential problem arising from a change made in the second consultative document. We refer to Section 1.9.1 'Eligible MDBs for a 0% risk weight', which contains a well-intentioned modification to allow recognized 0% risk weighted multilateral development banks (MDBs) to experience without reclassification a rating deterioration from their erstwhile AAA to as low as AA-. Unfortunately, this risks creating a double standard vis-a-vis other MDBs which never enjoyed a AAA rating at the outset, but which instead have steadily and copiously built up their credit profile to the AA level. It is thus possible that a downward trending MDB would enjoy a 0% risk weighting while the upward trending MDB would still carry a 20% risk weighting. Put differently, such a modification risks being perceived not as an accurate reflection of an institution's risk profile but as an indication of the institution's 'clout' with BCBS.

Moreover, we fully appreciate the stated desire of BCBS in Section 1.9.1 "to avoid potential frequent changes to the list of eligible MDBs subject to a 0% treatment." Our suggestion essentially removes the need for a list in the first place, retains the 0% weighting for AAA rated MDBs, but would also introduce an increased degree of nuance and sophistication relative to the current proposal. Otherwise, and as an example, two institutions in the 'other MDB' category would both receive a 50% risk weighting even if one were rated A+ and the other BBB-, a full five notches lower. Arguably, this creates a substantial disparity which renders equivalent two entities with very different risk profiles.

Allow me to clarify that we do not consider this commentary redundant belaboring. Rather, it is an appeal to BCBS to consider proposals which we believe are reasoned, balanced, and wholly consistent with the objective "to balance simplicity and risk sensitivity, and to promote comparability by reducing variability in risk-weighted assets across banks and jurisdictions" as mentioned in the BCBS press release of 10 December announcing release of the aforementioned second consultative document.

They are also timely, for as a consequence of the increased risk weighting of specialized lending operations of commercial banks, the entire MDB community will be called upon in coming years to increase its contribution to help meet the large gap in sustainable infrastructure, which looms as a bottleneck for further growth in emerging economies. We believe that our proposal is more compatible with this necessary but highly challenging sub-objective of the Global Sustainable Development Goals, and most significantly, can be applied while reflecting the credit profile of MDBs more accurately and consistently.

¹ BSTDB stands ready both to provide further detailed documentation about its own structure, its own operations and how it fulfills key criteria for MDBs, and to discuss more generally about the nature and activities of MDBs.

On the subject of MDBs, the draft consultative document *Revisions to the Standardised Approach for credit risk* represents an important step forward in addressing the issue of MDBs more thoroughly, laying out clear criteria for the determination of what a legitimate MDB is, something which will be very helpful for MDBs and the financial and other entities that deal with them. Nevertheless, the potential inconsistency remains, one which can be resolved efficiently and in a manner which strengthens the consistency of the overall regulatory framework. In addition to having a greater degree of objectivity, treating the issue of MDBs along the lines of sovereigns would be well justified and easy to understand and apply.

Once again, I would like to thank you for your time and interest in this matter, and to congratulate BCBS for the excellent work it regularly produces in such trying and uncertain times. As ever, please do not hesitate to contact me if you have any comments, and, at your convenience, I would be very happy to discuss the issue further.

Sincerely yours,



Ihsan Ugur Delikanli

Attachment: BSTDB's first letter dated 20 March 2015

President

Mr. Stefan Ingves,
Governor of Basel Committee on Banking Supervision
Governor of Sveriges Riksbank

Mr. William Coen
Secretary General of the Basel Committee on Banking Supervision
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Friday, 20 March 2015

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

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 "Qualifying 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
President

Black Sea Trade and Development Bank

OCPN	36114
Date	20/03/15
Subject	PRESIDENT
Project	BCBS / BIS
Format	Letter ☒ Fax ☐ e-file ☐ Cover ☐
Distribution	HC, DPS, GC, BST