

Comments on the Consultative Document of the Basel Committee on Banking Supervision

Revisions to the Standardised Approach for credit risk

Caja de Ingenieros¹ is a cooperative bank based in Barcelona, with 130,000 members across Spain, 350 employees and €2.5bn in assets under management.

We welcome the efforts of the Basel Committee to reduce the variability in risk-weighted assets (RWAs) and, particularly, the attempt to allocate the same amount of capital requirements to equal risks.

We would like to focus our comments on those aspects that, due to our size and high asset quality, are likely to be interesting to the Committee when discussing such far reaching regulation. Regarding the remaining questions posed by the Committee, please refer to the views expressed by the European Association of Co-operative Banks (EACB).

General comments

We fully support the aims of the current review and understand the difficulty in reconciling a set of simple calculations with the complexity of establishing a floor for IRB models. IRB models in certain regions have appeared to be rather weak at predicting the effects of the recent economic crisis. In our view, risk sensitivity is a step forward but intense risk sensitivity might be unable to cope with unexpected changes in the economy, even in the case of through-the-cycle models. In an uncertain economy, a reasonable framework should allow for a limited number of options.

Exposures to Banks

Q1. What are respondents' views on the selection of the capital adequacy ratio? In particular, is the CET1 ratio superior to the Tier 1 ratio or the Leverage ratio? Do respondents agree that it is necessary to require calculations in accordance with Basel III in order to ensure a consistent implementation?

The CET1 ratio is being used as a measure of prospective resilience in the most demanding Stress Tests performed by Central Banks and it seems reasonable to consider the current CET1 ratio as a good risk driver. While there are specific cases where the CET1 ratio was not effective as a risk driver, it should be acknowledged that external ratings were not much better. Moreover, at least in the European Union, Supervisors have access to an extensive amount of data and information, in more detail than the rating agencies, and Supervisors may request additional Capital Requirements through the Pillar 2 process. Therefore, as the CET1 ratio should

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represent the capital strength of a financial institution and Supervisors have a say on its actual level through Pillar 2, it seems reasonable to take CET1 as a proxy of risk.

- Q2. Do respondents believe the net NPA ratio is an effective measure for distinguishing a bank exposure's credit risk? What alternative asset quality measure, if any, should be considered by the Committee?

While we believe that CET1 should be aimed at summarising the capital base and risk profile of banks, the net NPA ratio is more likely to reflect the most recent state of affairs. However, there might be quite a high degree of subjectivity on what loans are non-performing and that would be likely to penalise those financial institutions that are more conservative in their risk management approach. Also, there are different accounting practices across geographies. Therefore, we would encourage the Basel Committee to promote a new NPA ratio that would be strictly limited to those exposures that are more than 90 days past due, and 30 days past due for securities. This new measure would not add much complexity to our current workload as we are already obliged to separate objective and subjective Non Performing Loans.

- Q3. Do respondents have views on the proposed treatment for short-term interbank claims?

The proposed risk-weight floor of 30% would require further explanation as it is not consistent with the aim of not increasing the overall capital requirements. Taking into account that these are 3-month exposures, the current 20% risk charge seems reasonable enough for banks with CET1 ratios above 7%.

Exposures to Corporates

- Q5. Do respondents have views on the selection of risk drivers and their definition, in particular as regards leverage and the incorporation of off-balance sheet exposures within the ratio? Would other risk drivers better reflect the credit risk of corporate exposures?

We acknowledge that Leverage has long been used as a major risk driver in credit models (i.e. structural credit risk models) and, while different industries and geographies are prone to have different Leverage levels, overall it often provides a good yardstick for risk.

Together with the Leverage ratio, we would have expected to find some measure of profitability (i.e. EBITDA/Total Assets) or, alternatively, a debt coverage ratio. We understand that these measures would also be controversial, but to a lesser extent.

The use of Revenue as a risk driver could be misleading. Certainly, size, whether measured by Revenue or Total Assets, is a factor that might influence the probability of default, but it also affects the level of diversification in the credit portfolio, which

might cancel out the risk due to the higher PDs. Also, having Revenue as a risk factor might create an incentive to lend to larger companies, which is not a suitable policy for smaller banks.

There are important implementation issues as well. While in Spain there is an obligation to file Annual Accounts in a centralised register, there are companies that fail to do so on time, and not just a few. Furthermore, many companies are not obliged to have their Accounts audited. In addition, it should be taken into account that it takes some time to feed these Accounts into a structured database, in a process that would not be a negligible cost for a small bank. The proposal gives an example about the availability of data that considers a period of 3 months between financial year end and the calculation of capital requirements. At present, that is unfeasible and, unfortunately, current business practices should be changed by other means.

An option to simplify the implementation would be to consider these risk drivers only at origination, unless it is a long term exposure (i.e. +5 years) or a large exposure (i.e. +€10 million). Also, the validity of Annual Accounts should be extended (i.e. 18 months from financial year end), and the risk weight when leverage and profitability data is not provided should not be higher than the current 150% applied to NPLs.

Retail portfolio

Q9. Can respondents suggest, and provide evidence on, how to increase the risk sensitivity of the regulatory retail exposures treatment, either by differentiating certain product subcategories for which a specific risk weight may be appropriate; or by suggesting simple risk drivers that could be used to assess the risk of all retail exposures?

While an alternative could be the use of behavioral models, they require significant resources and infrastructure for developing, validating and implementing them. There is always the possibility of relying on external scorings but that comes at a cost and, in our view, external scorings fail to capture the knowledge that we have of our members, which is gathered when the credit analyst is reviewing the credit application.

In our view, the current €1 million limit for retail exposures provides sufficient granularity to the capital framework. Lowering this limit (setting it at 0.2% of the overall regulatory retail portfolio) would overlook that the retail portfolio in small banks might be modest and that there are other portfolios that help diversify the exposure. As the 0.2% granularity limit would only affect banks with less than €500 million in the regulatory retail portfolio, it would break the principle of allocating the same amount of capital requirements to equal risks.

Claims secured by real estate

Q11. Do respondents have views about the measurement of the LTV and DSC ratios? (In particular, as regards keeping the value of the property constant as measured at origination in the calculation of the LTV ratio; and not updating the DSC ratio over time.)

As a small bank, we try to make the best possible use of our resources for managing credit risk. We focus particularly on the approval process and credit decision-making, normally through an analysis that is more thorough and detailed than the automatic approval models used by IRB banks for similar loans. However, once a loan has been approved, the resources available for its control are more limited, unless there are signs of impairment. It is worth mentioning that the continuous monitoring of a loan requires a substantial technological infrastructure and expenditure. Moreover, once a mortgage loan application has been approved, there are limited options available for mitigating risks if the credit quality of the client deteriorates. Therefore, we consider that the calculation of risk drivers for capital requirements purposes should only be performed at origination (value of asset purchased and DSC).

Regarding the debt service coverage ratio (DSC), it would be helpful to clarify which total income should be used if there are guarantors (i.e. a father backing his son when buying his first home). In this case, it seems to us that the principle of substitution could apply.

As the Committee is well aware, in the European Union the use of tranches is allowed when assigning risk weights and is a relevant aspect when calculating capital requirements in small banks, which normally have a large exposure to mortgage loans. Discretion should be granted to the National Authority for the treatment of tranches in mortgage loans.

Q18. Do respondents agree that instruments allocated to each of the CCF categories share a similar probability of being drawn and that the probabilities implied by the CCFs are accurate? Please provide empirical support for your response.

While the Committee is requesting empirical support, we would like to share our current business practices, particularly regarding Credit Cards. Our Credit Cards are mainly used as a means of payment rather than a credit instrument. However, by distributing Credit Cards rather than Debit Cards, we are able to provide our members with a broader range of services and advantages.