ASSOCIATION DES BANQUIERS CANADIENS | CANADIAN BANKERS ASSOCIATION

Box 348, Commerce Court West
199 Bay Street, 30th Floor
Toronto, Ontario, Canada M5L 1G2
www.cba.ca

Darren Hannah
Acting Vice-President
Finance, Risk & Prudential Policy
Tel: (416) 362-6093 Ext. 236
dhannah@cba.ca

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

Dear Basel Committee members:

Re: CBA[1] Comments on the Basel Committee consultative document:
"Revisions to the Standardised Approach for credit risk"

We appreciate the opportunity to provide comments on the consultative document, "*Revisions to the Standardised Approach for credit risk"*. The importance of the new proposed standardized approach (SA) is heightened as it is proposed to be used for capital floors, as well as for smaller banks, smaller non-IRB exposures, and new products and markets. We understand that the intent is that capital requirements should be commensurate with underlying risk to ensure appropriate incentives that align economic, pricing, and risk management decisions with capital requirements – but we are concerned that the proposal will create distortions and will lead to macro-economic inefficiencies internationally and nationally.

We generally support the objectives of the review, such as improving the risk sensitivity of the standardized framework and reducing the use of national discretion, but note that the objectives have inherent conflicts as increasing comparability of RWA is inconsistent with greater risk sensitivity. Moreover, while it is reassuring that increasing overall capital requirements under the standardised approach for credit risk is not an objective of the Committee, it is hard to see how the proposal can have any result other than increasing capital requirements for Canadian banks because, as currently framed, it increases the risk weights for the lowest risk asset classes.

The Canadian banking industry is concerned that the SA is being set to cover more than internationally active banks in Basel Accord countries. While a single global standard for all banks is a laudable goal, the SA should not be developed or calibrated to cover non-internationally active banks if that will make it less suitable for internationally active banks or if the attempt to have greater comparability will result in less risk sensitive and less accurate RWAs and capital ratios. The proposed SA in many aspects is not reflective of Canadian banks' (either AIRB or Standardized) proven history and lending practices evidenced in their loss experience.

[1] The Canadian Bankers Association works on behalf of 60 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 280,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

We believe that the proposals should continue to encourage financial institutions to enhance their risk management capabilities and that the SA must be set so that it does not create incentives to default to the SA rather than distinguishing between risks. Canada's largest banks have effectively operated (and been supervised) using the processes that accompany AIRB approaches for over 5 years and have fully adopted Basel III approaches. This practice contributed to the effective functioning of the Canadian financial services sector throughout the global financial crisis. In addition, incentives exist in the current rules for Canadian financial institutions to continue to enhance their risk management practices and for financial institutions that are currently using standardized approaches to pursue AIRB applications. Canada's AIRB experience suggests that the current SA risk weights are quite conservative in the Canadian context and the new SA should, to be more risk sensitive, seek to reduce the resulting RWAs. While this is partly a matter for calibration, if the revised SA does not generally lower existing SA RWAs for Canadian banks it will have failed to be more risk sensitive.

We are concerned as to whether the proposals in the consultative document will fully satisfy the BCBS's objectives. In general, we believe that the key risk drivers based on a two-factor model are not appropriately risk sensitive, are overly simplistic, may increase (rather than reduce) pro-cyclicality, and do not consider forward-looking information that is available through credit ratings. Of particular note is the absence of sufficient consideration of either collateral or credit quality which are crucial factors used in the effective credit risk management. In order to reduce the gap between the standardized and advanced approaches, we believe the proposals should give more consideration to collateral than is present in even the current standardized approach. In addition, we believe that moving away from external ratings will weaken rather than strengthen the link between the standardized and AIRB approaches and will result in less accurate and less risk sensitive RWAs and less comparable capital ratios. While we understand the desire to develop a SA credit risk regime that is risk sensitive, covers unrated exposures, and will work in countries where external credit ratings are not permitted to be the primary drivers, no other metric will provide objective evidence that reflects risk as well as external ratings. Consequently, we believe that external credit ratings should be retained.

While we support the objective of increasing comparability of capital requirements between the advanced and standardized approaches, we strongly believe that the main role of AIRB is to serve as a risk sensitive approach to measuring capital. We note that the benefits of risk sensitivity have been demonstrated for some higher default portfolios in banks operating in certain economic environments as the advanced approach risk weights may exceed SA risk weights. We also find that the proposed risk weights are particularly punitive to banks with low credit risk portfolios and would therefore create greater variation with AIRB approaches and, if used for a floor, will create a disincentive to good risk management and an incentive to take on more risk. In fact, our preliminary review suggests that the proposals are not capital neutral and may, in fact, result in a significant increase over AIRB capital across all credit exposure classes as well as an increase over the existing standardized approach and, in particular, for the proposed specialized lending category. We believe that the level of capital that would be required under this proposed framework is not consistent with Canadian banks' lending experience.

In addition, we would ask the Committee to be cognizant of the fact that the proposed revisions may influence business decisions and pricing by banks. By using non-risk sensitive drivers, we are concerned that the proposals could provide inappropriate incentives to make portfolios riskier. We are also concerned that the gap would be increased between economic risk and regulatory capital. Since the standardized approach will apply to all banks, either directly or through the floor for advanced approaches, this could also lead to increased systemic risk as banks will be charging the wrong amount of capital to risks and will, between risks, be encouraged to change pricing and availability of loans to reflect the new SA.

We would like to emphasize that before changing the standardised approach and introducing floors, the Basel Committee should investigate the removal of national discretion which presently allows differences in RWAs (in the current Standardised and AIRB approaches). This would assist in making ratios more comparable amongst jurisdictions but would not affect national discretion to require a bank to hold more capital under Pillar 2. The practice of requiring internationally active banks, due to local supervisory powers, to hold more capital under Pillar 1, or to have greater RWAs through non-transparent add-ons, floors and multipliers, needs to be replaced with transparent Pillar 2 requirements that increase capital but do not alter RWAs. The adoption of the Basel III leverage ratio also acts as the required backstop to low levels of reported RWAs.

With the above in mind, we are pleased that the BCBS recognizes that the proposals are still at an early stage of development and that the Committee seeks respondents' views and data to enhance the proposals. We welcome this opportunity and present some suggestions for improvements in our response. We also believe that the QIS that is underway on the proposed revisions to the standardized approach for credit risk is essential for an accurate calibration of the proposed standardized approach but we are concerned that the QIS will be of limited use because much of the data required for the two-factor risk drivers is not available in regulatory capital calculation systems. It will take time for banks to obtain the data required for the QIS calculations and for supervisors to analyze the QIS data and compare the resulting RWA factors against actual historic loss experience in their jurisdictions to determine the reasonableness of the results. We expect that subsequent QIS will be required if the SA is to be properly calibrated once the proposals are finalized. Finally, we look forward to the upcoming phase two of the BCBS's review of the Pillar III disclosures as we also have concerns with the possible disclosure of hypothetical capital requirements according to the standardized approach for credit risk for AIRB banks.

We have provided comments on some key issues below, along with some suggested improvements for the proposals. Detailed comments are included in the attached appendix including our responses to the questions posed in the consultative document.

Proposed Risk Drivers

The proposed use of the CET1 ratio and net NPA ratio as a two-factor model for rating bank exposures is concerning. Capital ratios are not considered to be sufficiently risk sensitive given they are known to be slow to fully reflect realities and are backward-looking given the reliance on year-end figures. Capital ratios are also pro-cyclical as the decline in CET1 ratios for obligor banks will increase RWA and decrease CET1 ratios for exposed banks, which will decrease the CET1 ratios in the obligor banks if the exposures arise in a bilateral relationship (e.g. counterparty credit risk), and so on. Moreover, many jurisdictions are not on Basel III or have distorted the ratios through national discretion, and therefore comparable CET1 ratios for their banks will not be available unless banks and regulators produce "clean" and consistent Basel III ratios. We also note that the CET1 ratio is a measure of regulatory confidence and whether a bank will continue as a going concern – total capital ratios are a much better indicator of whether a creditor bank is exposed to loss as it is quite possible that a bank with low CET1 will fail but its other capital and sources of loss absorbency will result in no losses to banks and other senior creditors, particularly if such creditors are not subject to bail-ins. We also believe that the net NPA ratio is a questionable measure as the definition for the calculation is not simple, it will be burdensome to implement, is pro-cyclical, and is not likely to be consistently applied by reporting banks. Finally, any such risk factors for banks must be adjusted for country risk as a bank is reliant on the strength of its sovereign, currency, central bank, and national economy – i.e. two banks with equal risk drivers but different country risks require different capital to properly reflect their risks.

For corporate and retail exposures, we find that the proposed risk drivers are in many cases divorced from the tools currently used by banks for credit underwriting. While leverage is an important risk indicator, high/low leverage can only be determined in the context of the industry and markets in which a corporate operates (e.g. a regulated utility may have high leverage but be a low risk and a resources exploration company may have low leverage and be a high risk). On the other hand, the size of a corporation's revenues is not a good predictor of its risks and again the context (markets, industry) matters. Importantly, the risk drivers do not give sufficient recognition to the role of collateral, which would be particularly important for the proposed specialized lending category. Banks' experience and practice demonstrates that collateral is a key component of credit adjudication. Maturity is also not considered in the proposed framework although this variable is used in the determination of risk-weighted assets in the advanced approaches and is universally considered relevant when evaluating the riskiness of an exposure.

The proposed revisions consider credit quality for corporate exposures using a limited set of risk drivers which do not encompass the same forward-looking elements and qualitative factors that are employed in external ratings. These risk drivers, as mentioned above, are not suitable for evaluating the riskiness of regular corporate business exposures – they will result in more granular risk assessments without resulting in more accurate and informative risk assessments. Further, when non-traditional corporate / business exposures are considered (e.g. non-profits, trusts, government agencies), the two risk factors proposed may have no applicability. The choice of risk drivers also does not reflect jurisdictional differences such as covenants, tax regimes, and legal requirements. We recommend that external ratings be retained where they are available and permitted and that, as a fallback when ratings aren't available, banks should be permitted to risk weight corporate exposures into a small number of categories by considering their riskiness (e.g. high/low investment grade or non-investment grade, watch list and default) and that supervisors (subject to RCAP) would review whether such slotting takes place in accordance with a master scale and external ratings in a way which is consistent and transparent.

While the key principles and objectives that the risk drivers must be 'simple', 'intuitive', 'readily available', and 'capable of explaining risk consistently across jurisdictions' are welcome, we are also concerned that achieving all of these objectives simultaneously will be very challenging. For example, the use of simple metrics for all jurisdictions and industries fails to meaningfully differentiate risk across a wide range of portfolios. Risk drivers such as the LTV and DSC ratios for exposures secured by residential real estate will not be interpreted in the same manner across jurisdictions leading to a lack of comparability. Differences in accounting principles across jurisdictions will also affect the comparability of these financial measures. Local markets and differences in industry and market structure mean that even seemingly consistent risk drivers will need to be set to different levels to achieve comparable results such as LTV.

Finally, we believe that the proposed risk drivers add to pro-cyclicality concerns instead of reducing them. Risk drivers such as revenue, LTV, DSC, and the CET1 ratio will increase in good times and decrease in bad times. By comparison, the current standardized methodology is not prone to pro-cyclicality. Improving risk-sensitivity at the cost of increased pro-cyclicality would appear to have no benefit and is counter to the Basel III reforms that sought to reduce pro-cyclicality and build in shock absorbers into the banking system.

Further comments on the proposed risk drivers for the different exposures are provided in our detailed comments.

Credit Capital Floors

We would expect overall risk weights under the revised standardised framework should continue to be more conservative relative to the AIRB framework as the latter is intended to encourage and reward banks for developing more sophisticated processes and systems to assess credit risk and effectively manage capital required for the banks' exposure. However, the current proposal seems to be built on the concept that a bank may use risk sensitive and risk management sensitive internal models only if they lead to results above a floor. From a more theoretical viewpoint this implies that banks are stimulated to improve their risk management only until they reach that floor. Once operating at the floor or below all incentives to further improve would disappear and at that stage a bank could rightly question the added value of internal models. The floor de facto introduces another undesired cliff effect: full recognition of internal models and risk management incentives above the floor, but no recognition at all below.

It has been suggested that the variation in risk weights for similar exposures under AIRB approaches continues to be a major issue in respect of consistency and comparability. First, while RWAs differ, it has not been shown, once national supervisory discretion is removed, that the differences are due to inaccurate risk assessments or due to improper use of internal models – to the contrary, with closely supervised AIRB models, the likelihood is that the differences in RWA are due to differences in risk profiles, diversity in models, and choices in risk management. Second, even if RWAs are ultimately shown to differ for undesirable reasons this should not be dealt with simply by imposing higher floors as this will effectively eliminate AIRB banks' extensive efforts to differentiate credit risk at the higher quality end of the risk spectrum. We believe that the minimum risk weights in the proposed standardized approach imply floors for risk weights, which are too high for some high quality counterparties. For example, the minimum risk weights of 60% for corporate exposures and 30% for bank exposures are too high and we believe that the corresponding grids should be re-calibrated. In fact, the Canadian experience suggests that SA RWAs are too high and should be re-calibrated lower.

We urge the BCBS to not artificially raise the capital floors that are not risk sensitive to mitigate the variation in risk weights observed across banks and/or jurisdictions, or seemingly low risk weights for some banks under AIRB approaches. Differences in RWAs that reflect differences in risks lead to capital ratios that are more comparable; incenting or requiring banks to have consistent RWAs for similar exposures that represent different risks will result in capital ratios that are less comparable and less meaningful. We recommend that the Committee attempt to identify and focus on the portfolios and/or exposures that are of material concern and to use the national (e.g. AIRB review) and international (e.g. RCAP) supervisory tools at their disposal to reduce unacceptable (e.g. not fact-based) differences.

Implementing higher credit risk capital floors not commensurate with risk can also adversely impact lending activity as exposures to a higher quality obligor that otherwise would have attracted lower capital will be risk weighted the same as a relatively riskier obligor. Further, once the SA becomes the binding constraint through floors, banks will be incented to focus their business based on the relative RWA intensity of different businesses in an attempt to earn better returns. If so, lending and economic activity can become distorted.

The Canadian banks have undertaken extensive efforts and devoted significant resources to develop and maintain robust models, processes and systems to measure and manage credit risk, thereby ensuring capital commensurate with risks in our portfolios are adequately captured in compliance with the Basel AIRB framework. Under prudential supervision by OSFI, we believe that we have established more than adequate internal and external governance processes overseeing AIRB implementation. We therefore do not believe that the contemplated revisions to the standardised framework, including capital floors, should be permitted to adversely impact Canadian banks' existing capital requirements under the AIRB framework and potentially create a step backwards without due consideration and evidence that such risks are not properly capitalized.

We have also provided further comments on capital floors in our separate response to the BCBS consultative document *"Capital floors: the design of a framework based on standardised approaches"*.

Suggestions for improvements

For bank exposures, we suggest that external credit ratings and sovereign ratings be retained. These may be used together with a capital ratio-based metric provided it is adjusted for country / systemic risk. We strongly believe that external ratings have value as forward looking measures that provide more risk sensitivity. We also find that many financial metrics have value when assessing credit risk of a bank together with sovereign/country risk assessment. The administrative burden on standardized banks could also be reduced, and RWA consistency improved, if regulators were to take responsibility for determining the risk weight percentage appropriate for each bank that they supervise pursuant to a transparent and objective internationally agreed framework consistently applied and subject to RCAP-type international review.

For the rating of corporate exposures, we suggest two options below that would also involve the retention of ratings, which we believe provide a better representation of risk through the incorporation of an assessment of credit quality. For example:

- Having two measurement options, one being external ratings and the other being the proposed risk drivers, if ratings are not available, that are calibrated to local and industry circumstances through an objective and transparent market indicator.
- Exploring the use of banks' internal rating processes which would be brought together in a way to construct a set of standardized risk weights for individual obligors.

For retail exposures, we recommend a differentiation between secured and unsecured exposures. We believe that the current 75% SA risk weight should continue to be applied for the rating of unsecured retail exposures. However, we believe that a materially lower risk weight should be applied for the secured part of any retail exposures based on the value of collateral at inception which should be objectively determined.

For exposures secured by residential real estate collateral, we recommend that the current definition that includes both owner occupied and rental properties be maintained. The proposed definition in paragraph 36 differs from the AIRB approach and from current bank lending practices, which could decrease comparability between financial institutions. We also believe that collateral should be recognized as a factor in the rating of real estate exposures.

For the rating of residential real estate exposures, we suggest the use of an internationally agreed global LTV metric that would be calibrated to local circumstances based on local housing market conditions. We recommend this process be done in an objective, fact-based, and transparent manner. We believe this would be different from national discretion as we suggest that the global metric and calibration process be subject to rules set by the BCBS and also subject to BCBS review similar to the RCAP.

While LTV is a strong risk driver for residential mortgages and could be calibrated between countries to be comparable (e.g. based on maximum national house price decline), DSC cannot be made comparable across jurisdictions and banks and quickly loses its risk differentiation power as some jurisdictions permit borrowers to walk-away on mortgages and failure to pay in other jurisdiction is due to life events causing lost cash flow (not due to an inability to supply existing cash flow due to the competing demands measured by DSC). As such, we strongly oppose using DSC as a risk driver. By contrast, we believe that higher than normal customer credit risk (or the ability of a mortgagor to walk away from their mortgage) should be reflected in some form for residential mortgages, as for other retail exposures. For example, high-risk sub-prime mortgages to customers with no /short credit history or previous major delinquency should not receive the same risk weight as prime mortgages.

For SMEs, we are concerned that the proposed revisions do not retain the size factor from the current standardized approach and may therefore disadvantage lending to smaller firms. We recommend that the size factor be retained.

We recognize that one of the BCBS's objectives is to reduce national discretion. Where feasible, however, local differences which materially change the SA risk profile should be objectively included in the SA (e.g. adjusting LTV levels based on national house price volatility) and, for banks that are not internationally active, national discretion may be retained, as appropriate, to reflect further local circumstances. For example, national discretion may be important to overcome jurisdictional differences for locally active banks in certain areas such as tax and corporate laws. It is also important from the standpoint of not having a "one size fits all" approach when the goal is not a consistent SA for internationally active banks. An example of a material national difference that must be built into the SA for inter-nationally active banks is the role of mortgage insurance or other government guarantees – e.g. Canadian residential mortgages are inherently different than the risk profile of residential mortgages in other parts of the world.

Further suggestions for improvement to the proposed revisions to the standardized approach for credit risk are provided in our detailed comments.

Implementation

Our strong preference as an industry is to postpone the finalization of the new SA until after the current Basel III reforms are in place and are digested by the market – e.g. the Basel III leverage ratio is a new risk insensitive standardized approach which is just now being disclosed and is still non-binding. While we are pleased that the Committee will provide sufficient time for implementation, including appropriate grandfathering provisions where necessary, the SA will have very broad ramifications and should not be implemented until its impacts on banks, risk management, and the availability of credit are fully understood. Given that there are a substantial number of items that still require consultation with the industry across jurisdictions, and potentially material changes in capital and significant IT implementation requirements, we would suggest that the timing of finalization of the revisions be at least two years to allow multiple QIS for calibration and studies of macro-economic impacts (i.e. 2017) followed by implementation of at least two years thereafter for transition once the new SA is established. We note that there are also a number of current BCBS papers requiring implementation by 2017 which require significant resources as well.

There are also significant IT efforts involved with the proposed changes, thereby requiring a longer implementation period. This is based on the fact that most of the financial risk drivers may be available and disclosed by the corporates or banks but would not necessarily be currently captured centrally for capital or reporting purposes by each bank. Banks may have also operationalized their processes using databases that report certain metrics (i.e. net NPA ratio) but any deviations in the calculation of these metrics (i.e. as contemplated in the consultative document) will result in the need for enhancements. Thus, there will need to be some system development to capture the additional data requirements.

We also strongly encourage the BCBS to finalize all of the revisions to the standardized approaches for credit, market, and operational risks before considering the calibration of capital floors.

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

Sincerely,

Attachment

cc: Catherine Girouard, Director, Bank Capital, OSFI
Mary Thomas, Senior Analyst, OSFI

CBA Members' Comments and Requests for Clarification

Executive Summary (p. 1)

Please refer to our accompanying letter for our overall comments on key issues. Additional comments are also provided below.

- The Committee should be mindful that the assessment of credit risk for Corporate exposures is by nature generally more complex and it is not feasible to apply simple and readily available information to differentiate risk accurately. In fact, even under IRB approaches, the modeling of risk weights using more sophisticated statistical approaches and extensive data and the comparability thereof across banks and jurisdictions remains a huge challenge.
- In the case of corporate and bank exposures, the elimination of external ratings as a risk driver may not achieve the objective of higher risk sensitivity. Historically, the reliance on external ratings has proved problematic in the case of sovereign and securitization exposures, but has worked well for assessing bank and corporate exposures. Also, the quality of external ratings has improved since the financial crisis.
- As key drivers for credit risk, external ratings (as well as sovereign ratings) incorporate forward-looking components, which are very valuable inputs for the standardized approach. Replacing external ratings with more simple risk metrics will weaken rather than strengthen the link between the standardized approach and the IRB approach.
- We are concerned about removing incentives to improve risk management practices. The proposals also consider only inherent risk, rather than residual risk after consideration of risk management and controls. The proposals assume that "specialized lending" is inherently more risky and this may be true if specialized lending is completed by non-specialist lenders. On the other hand, if specialized lending is completed with appropriate risk management and control activities, the residual risk can be very low. A proposal only focused on inherent risk ignores risk management activities (unlike AIRB which is built on a firm's own historical data) and is therefore not truly risk sensitive.
- We have concerns about the complexity involved in implementing the proposed standardized approach and the impact on the development of advanced modelling approaches. This will potentially penalize banks adopting advanced approaches that have invested heavily in infrastructure in developing and validating advanced approaches to credit, market, and operational risk modelling approaches and will divert resources away from improving these systems in lieu of developing less sophisticated approaches.
- The proposed standardized approach introduces large data collection/maintenance burdens for banks in retaining information that may not be presently available. Certain risk drivers could also vary from quarter to quarter, causing instability in risk weight measurement.
- For banks that are currently under a Basel I or a standardized Basel II approach, these proposals may be more applicable and relevant as they develop more sophisticated approaches and seek AIRB and AMA approvals.

CBA Members' Comments and Requests for Clarification
• The definitions of certain terms (e.g., non-performing loans and exposure categories) need to be more explicit and precise, and should also closely align with those in the IRB approach. • We believe that there are also alternate mechanisms that exist under Pillar II and III that can accomplish the BCBS's objectives and ensure that a conservative amount of capital remains in the system and that results are transparent and consistent across jurisdictions. In fact, the proposed Pillar III disclosure requirements are aimed at promoting consistency of disclosures. Heightened supervisory reviews under Pillar II including cross-sector benchmarking reviews, D-SIB requirements, stress testing, and other ICAAP processes also ensure results are conservative and capital is adequate to withstand downturns.
Section 1: Background (p. 3)
Limited Drivers While application of 1 or 2 risk drivers will meet the simplicity objective, these limited drivers will not comprehensively cover the overall risk of the entity and can result in mis-estimation of the underlying risk. If risk drivers are carefully selected and calibrated (e.g. to local and industry circumstances) this may ultimately be better than a blunt fixed risk weight measure as is currently applied to unrated exposures – this work will, however, take significant time and resources. **Consistency in Driver Calculation** For the same obligor that different reporting banks may have exposure to, one would expect that the calculated financial driver and hence the reported risk weight should be the same. To facilitate this, it is strongly recommended that subject obligors be required to provide the calculated financial driver such that all reporting banks are using the same information. Additionally, all jurisdictions need to work closely together to ensure the reporting requirements are consistently enforced given there will be differences in accounting standards. **Calibration of risk weights** Subject to QIS results that provide for comparison of standardized risk weights with IRB risk weights, there will need to be substantive work and consultation with industry to calibrate appropriate risk weights. A 300% risk weight is too punitive for obligors that have not provided the required driver information. By comparison, a problem obligor with PD of 10%, LGD 45%, and maturity of 3 years would be subject to a risk weight under AIRB of only 200%.

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(1.1) Objectives of the review (p. 3)

We believe that the Committee's objectives are laudable, but given they are sometimes conflicting and these matters are complex (and timelines are short), we question whether they are reasonable. However, in an effort to distance its reliance on external ratings, the BCBS has selected certain financial metrics and assumed they represent risk sufficiently. It is not possible to assess an enterprise's credit risk using a select few drivers which are historical by nature, do not consider future potential, strength of management, industry position, country of exposure, diversification, etc. In addition, based on the proposed set of drivers chosen, it will be difficult to ensure consistent treatment across entities and jurisdictions. This proposal requires more discussion and analysis to ensure the Committee's objectives are achieved.

Before changing the standardized approach and introducing floors, the Basel Committee should also investigate the removal of national discretion which presently creates differences in RWAs (in the current Standardised and AIRB approaches). This would assist in making ratios more comparable amongst jurisdictions but would not affect national discretion to require a bank to hold more capital under Pillar 2.

Objectives should include the assurance that standardized approaches will be sufficiently practical to ensure consistent treatment and outcomes across institutions and jurisdictions to ensure a level playing field and unambiguous results.

(1.2) Weaknesses of the current standardised approach for credit risk (p. 3)

We do not agree that use of external ratings is a weakness of the current standardized approach. Despite some shortcomings in the ratings of securitizations prior to the 2008/2009 crisis, external credit ratings provided an independent and reliable source of risk assessments.

External ratings may have problems, but these ratings are based on historical performance (including financial metrics), forward-looking elements, and factors that cannot be quantified (e.g. management, corporate governance). Although external ratings cannot serve as a substitute for internal credit analysis, they are, as one of the key drivers of credit risk, still very useful and valuable as inputs for the standardized approach. Completely removing external ratings as well as sovereign ratings from the standardized approach and using metrics based on only two drivers will not achieve the intended results (e.g. to be more in line with IRB, more risk sensitive, and more comparable), and will therefore weaken rather than strengthen the link between the standardized approach and the IRB approach.

The purpose of capital is also to weather future risk-based on a forward-looking and comprehensive credit assessment, but the new approach fails to incorporate forward-looking elements. We suggest that external ratings should be used when available, together with slotting of risks based on a bank's master rating scale as a fallback approach (which may be supported by risk drivers such as simplified ratio metrics), for unrated exposures or in countries where ratings are not permitted. Reliance on other means is less practical, more difficult to implement, and will reduce risk sensitivity.

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Increased granularity will only enable greater risk sensitivity if the calibration is based on empirical data rather than arbitrary risk-weight ranges.
(1.3) Principles and rationale for the review (p. 4)
We largely agree with the stated principles. However, as IRB provides the more accurate approach to determine risk weighting, banks should be encouraged to migrate to IRB where possible. For this reason, we suggest that in Principle #2 an allowance be made for a 'small' upwards bias in risk weights for standardized portfolios relative to similar IRB approaches. Any chosen set of risk drivers may differentiate risk but certain drivers are likely more meaningful from a credit risk perspective. Solvency ratios may not be as meaningful vs. other factors which represent the long term success of an enterprise. For example, credit risk managers may not view solvency ratios as a main risk driver. Ratings from external credit rating agencies are likely a more comprehensive attribute than a specific standalone financial metric which ignores other financial metrics. A wholesale change in approach to other risk drivers would require an extensive re-calibration to ensure the risk-weighting is commensurate with the risk. Regarding Principle 6 - *Definitions used in the standardised approach should, to the extent possible, be harmonised with those used in the IRB framework*, does this mean that some existing definitions used in the IRB approach, where applicable, will also need to be changed if they are different from those in the proposed standardized approach? We are seeking clarification on this point.
Section 2: Proposed revisions to the standardised approach for credit risk (p. 5)
Risk drivers should be based on consistent and transparent financial statement items. Consideration should be given to : • Clarifying the information that should be used to calculate the risk drivers, and • Addressing potential significant discrepancies due to the use of various accounting frameworks. The amount of necessary information at the granular level is also significant and potentially difficult to obtain for purchased assets. The implementation of a new guideline will potentially have a significant negative impact on the AIRB coverage ratio.

CBA Members' Comments and Requests for Clarification
(2.1) Exposures to banks (p. 5)

Definition 2.1 (i)

- The definition appears to allow Bank treatment for any deposit taking financial institution that is subject to prudential regulation and which publishes the relevant asset quality and leverage ratios. The proposed definition is not sufficiently clear and will result in differences in the identification of qualifying banks. Further clarification on the consistency of the definition of Bank exposures between the proposed standardized approach (Annex 1 paragraph 12) and the Basel II IRB approach (Basel II paragraph 230) is requested.
- In relation to the proposed definition of banks as "any financial institution that is licensed to take deposits from the public, and is subject to the prudential standards and level of supervision in accordance with the international practices relevant for such an institution" (Annex 1, paragraph 12), we seek clarification, in particular, on the following points:
  - It appears that mutual fund companies and brokers/dealers would be brought under Corporate. We do not believe this would be the appropriate classification and we seek clarification on this.
  - Whether this definition is intended to include insurance companies subject to Solvency II? Since insurance companies may not qualify under the Bank definition, they would fall under Corporates. However, since insurance companies do not have revenue ratios they might get penalized with the highest risk weight rate.
  - Whether the definition of financial institutions for the financial institutions deduction threshold would also change? For instance by excluding hedge funds, mutual funds, etc.
  - The proposed drivers may not be "business-model" neutral. A lack of funding and leverage metrics may result in wholesale funded banks with relatively small loan portfolios (typically investment banks) having a lower risk weight than a comparable commercial bank with a sizeable loan portfolio.
  - Whether government owned and controlled banks with a public policy mandate need to be risk-weighted as banks, or if a risk weight based on the Sovereign would be more appropriate.
- We propose that each jurisdiction should provide a publicly available list of banks that meet the definition which will ensure that all banks are applying risk weights consistently for the same subject bank.
- We believe that external ratings where available for banks provide a good level of risk sensitivity that allows banks to rely on them. External ratings should be used under the standardized approach to assess bank exposures where available. Where not available, a slotting approach based on a banks master rating scale, potentially incorporating the two proposed risk drivers once they are developed, could be used for the purposes of improving risk sensitivity.
- The additional risk drivers proposed will require significant data sourcing efforts to ensure that they are captured in risk systems for use in capital calculations.
- Adopting the new rules will be burdensome for subsidiary entities reporting. We suggest an alternative such as external ratings, if allowed by the jurisdiction, providing the subsidiaries are not externally reporting.

CBA Members' Comments and Requests for Clarification

Risk Drivers (2.1 ii)

- Moving from agency ratings to financial ratios as drivers of RWA means that we lose the forward-looking aspects of agency ratings. Financial ratios are inherently backward-looking and so will always lag the evolution of the obligor's actual risk profile. Agency ratings attempt to provide some element of forward risk assessment. The potential result is that capital requirements will be lowest prior to a credit stress period, and highest afterwards, which is the opposite of the desired policy objective. This raises the question of whether regulators should compensate for the loss of a forward-looking element in RWAs by introducing some other technique. This could include a mechanism to adjust the risk weights to reflect the state of the credit cycle.
- The weaknesses of relying on agency ratings are well recognized, but dispensing with external ratings has implications beyond the standardized RWA calculation. For example, many derivatives agreements have ratings-based triggers (often to allow early termination or to require additional collateral upon downgrade). For example, some financial institutions may rely on the agency rating as the primary driver of the risk assessment for "negotiable paper" limits for corporate debt securities held in trading portfolios. Do any of these needs have to be reconsidered to reduce the potential distortions arising from the use of agency ratings?
- Depending on calibration, the use of a small number of financial ratios to derive risk weights may result in risk assessments that may be reasonable in aggregate, but these reasonable in aggregate results may differ materially from the results of a more fulsome analysis for specific obligors. So even if the RWA for a standardized bank is reasonable in aggregate, the RWA attributed to a specific exposure may be distorted, and this could lead to new pricing anomalies and inefficient credit markets.

Risk Weight Methodology (2.1 iii)

- How often will a bank need to update the risk weights for exposure in its credit portfolio? Since banks typically publish results every quarter, do the ratios need to be updated every quarter? Can this be harmonized with the bank's internal review of the obligor's financial statements, or do risk weights need to be updated in a more timely manner based on new disclosures by obligors in the portfolio?
- It is not transparent but it appears that the financial ratios are to be determined from the unconsolidated statements of the obligor. These statements are not always easily available. This is likely intended to ensure that financial resources held at a subsidiary are not assumed to be available for the parent; the subsidiary may be unwilling, unable, or prevented by its regulators from providing support to its parent. This view, the complete absence of intercompany support, is a harsher approach to risk assessment than is currently used by rating agencies and by likely most of the Advanced IRB banks as well.
- Need confirmation that any bank or securities dealing subsidiary for which the key financial statement ratios are not available needs to be risk weighted @ 300%, rather than the parent's risk weight. This is likely to result in 300% risk weights for many securities-dealing subsidiaries.
- For financial institutions that have large bank exposures in emerging markets, removing the sovereign ratings may inappropriately decrease the risk weight measures.

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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? (p. 7)

We believe that CET1 is higher quality loss absorbing capital and represents confidence that a bank is likely to remain a going concern but total capital is a better prediction of whether a senior bank creditor is exposed to loss. We also recognize that leverage exposures are not risk-sensitive. As most banks are now generally managing to CET1, we therefore agree that CET1 would be an appropriate measure for the probability of default of banks that are required to publish this metric although total capital ratios are a much better indicator of whether a creditor bank is exposed to loss. Nevertheless, we have a number of concerns with the choices that are presented as noted below.

- Common equity Tier 1 and total capital ratios are comparable and highly correlated. While these ratios indicate capital adequacy, they are managed ratios by the bank that do not change materially in most cases and will not be sufficiently sensitive (particularly when some weak institutions may be required by their regulators to add capital).
- Use of the CET1 ratio appears to violate the proposal's own principle of not relying on internal modelled approaches set capital charges (principle 4 in section 1.3).
- Capital ratios are known to be slow to fully reflect realities and backward-looking. It is well-documented that many bank failures in the financial crisis were not correlated to weak capital ratios. Five days before its bankruptcy Lehman had a Tier 1 ratio of 11%.
- It is difficult to accept that the CET1 ratio and NPA ratio by themselves are superior to credit ratings (despite their past failures). Presumably banks' capital ratios and NPA ratios are only a fraction of credit rating agencies overall analysis. There are other indicators/factors that affect banks' ability to re-pay their obligations such as their leverage, liquidity position, business mix/model, economic cycle/outlook, market indicators (stock price, credit spreads), sovereign/political/legal/reputational risk, etc. that are not considered as part of CET1 and NPA ratios.
- Replacing external ratings with the proposed risk drivers will result in a loss of information and actually reduce risk sensitivity, contrary to the Committee's intent. There are many factors including capital adequacy that are included in external and internal credit ratings that should be considered.
- Solvency ratios may not be predictive of risk. Strong solvency ratios may be indicative of increased business results volatility, local regulatory requirements and not indicative of long term success. Using CET1 as an input to our RWA calculation is directly pro-cyclical due to credit migration, impacts from lower earnings, etc.
- Use of a CET1 ratio is complicated because not all jurisdictions are on Basel III and it is not possible for banks to calculate another bank's pro-forma ratio since RWA varies (e.g. Basel I vs. III or due to national discretion) and certain deductions do not appear in published financial statements (fair value of changes in own credit worthiness, deferred tax assets on a gross basis, investments in financial institutions greater than 10%, etc.) Alternatively, we cannot simply use a CET1 ratio provided by a counterparty which does not follow public disclosure standards and controls.

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• The method should not mix the use of Basel II Tier 1 ratios for some jurisdictions and Basel III Tier 1 ratios for others. There needs to be a common regulatory capital ratio across all jurisdictions; otherwise, an alternative more consistently calculated driver/metric should be chosen. • Requirements that CET1 be at the legal entity level are impractical. Many entities are wholly owned. Ratios are not publicly disclosed. Local entity ratios are more likely based on a derivation of Basel I requirements. If chosen, we recommend that CET1 at the consolidated level be used. We agree that Basel III rules (with full transition) should be applied for consistency across jurisdictions. For jurisdictions that are not yet subject to Basel III, a default risk-weight could possibly be considered. A secondary set of weights could also be used if the Leverage ratio needs to be used instead of CET1 for such banks. Clarification is requested on whether the CET1 ratio used would be the capital floor adjusted CET1 or not, given the new rules proposed for capital floors. We agree that the ratio calculation should align with the Basel III disclosure requirement such that it is readily available and consistently calculated by the subject obligor bank. This however will be problematic for banks that are not subject to Pillar III disclosure.
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? (p. 8)
We believe that the net NPA ratio is a questionable measure for distinguishing a bank exposure's credit risk. While this metric is one measure amongst others to assess credit risk, the definition for the calculation is not simple, it will be burdensome to implement, pro-cyclical, and is not likely to be consistently applied by reporting banks. As a result, we strongly recommend that external ratings for bank exposures be retained. Another asset quality measure similar to NPA such as Provisions/Loans may also be more readily available and useful. Other concerns that we have with the net NPA ratio include: • The practicality of keeping aware of our obligors having breached <u>any</u> binding minimum prudential standard in order to apply the 300% risk weight. If so, national supervisors should be responsible for compiling a list of such banks in its jurisdiction. These lists could be centralized at the BIS level. At the same time, publishing such lists could have other unintended consequences. • The NPA ratio may be an indicative measure of loan quality, but for banks with large securities operations, this could be inadequate and misleading. Such banks may not have large portfolios of loans to make the NPA ratio an effective measure. • Net NPA ratio for a bank could also be volatile from quarter to quarter, causing instability in risk weight measurement.

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• The NPA ratio can be greatly influenced by portfolio growth/acquisitions and accounting changes (IFRS 9). The definition of non-performing loans does not seem consistent with accounting standards (IAS-39/IFRS 9) and several terms in the definition would need more precise definitions (example: 90 days past due can be interpreted in different ways (different start date). • NPA will have varying definitions across institutions and accounting regimes. Forcing all banks to conform to one definition will result in significant work effort/systems and/or data changes which will take time to implement. We also believe that inherently NPA would be captured in capital and leverage ratios. For example, higher non-performing loans would result in higher RWA and lower equity to support RWA (via a slower increase to retained earnings or decrease in retained earnings). At the same time, a firm with low leverage but a higher NPA may not be as risky given lower levered banks would likely experience slower rates of decrease in CET1 during a downturn. As the same risk weight should be assigned to common obligor banks, we do appreciate that the Committee would mandate disclosure requirements of the NPA ratio of all banks if this metric is chosen such that the net NPA ratio is readily available for the determination of risk-weighting. Per footnote 13, we understand that all necessary information will be part of the Basel III Pillar III requirements. We wish to stress that if this is not done, it would be a significant burden for banks to internally calculate the net NPA ratio for each of their borrowers. At the same time, we believe that metric review should also follow the bank internal credit risk review cycle timeline (as in AIRB) and should not only be defined by when the obligator published their Pillar III report (i.e. annual revision of Basel risk parameters). We would also request further clarification on the consistency between the definition of non-performing assets for the net NPA ratio calculation and the Basel II definition of default for IRB approach (Basel II paragraph 452-457). For example, 30 days past-due for investment debt securities.
Q3. Do respondents have views on the proposed treatment for short-term interbank claims? (p. 9)
We agree that these exposures should receive preferential treatment due to their short term nature; however, imposing a risk weight floor of 30% could be overly conservative and contrary to a risk sensitive approach. For example, a senior unsecured exposure to an investment grade bank with PD of 10bps, LGD of 35%, and a 3 month term would be assigned a risk weight of only 10%. Without the external credit rating as a driver, we also find that the risk weight for short-term interbank claims will have a material increase for exposures currently rated above B-. A floor of 30% is considered too high for high quality short-term interbank claims, and the reduction should be more than 20%, or these exposures should be rated based on risk categories (e.g. up to 10% for investment grade equivalent claims, 20% for non-investment equivalent).

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We also note that short-term claims that are expected to be rolled over for liquidity purposes would not receive preferential treatment. The guidance ignores the intent of management and the impact on the market including a high likelihood of regulatory arbitrage. We believe this unduly increases the risk-weight of these exposures even though other Basel frameworks suggest the maintenance of highly liquid assets is required. We recommend that the wording "expected to be rolled over" be removed (p. 9 of the consultative document). We also believe that short-term interbank claims should be defined on the basis of residual maturity and not original maturity, as any short term claim has the reduced risk. The proposed approach also layers on the original approach, modified under certain conditions for short term claims. There are essentially 2 calculations which makes it impractical and overly burdensome to implement. We also have following questions: • Are claims with no explicit maturity to be treated as short-term? • Why should this benefit be restricted to obligors that would otherwise receive <100% risk weighting? • The duration of other exposures (e.g. corporates) is also a relevant risk factor and should be considered.
Q4. Do respondents have suggestions on how to address these concerns on the treatment of exposures to banks? In particular, do respondents have views on how to treat exposures to banks not subject to Basel III in a consistent and risk-sensitive manner? (p. 10)
One alternative would be retaining external credit ratings and sovereign ratings for Bank exposures, which may be used together with a metric based on ratios. The BCBS could also consider the impact of jurisdiction (i.e. OECD vs non-OECD domiciled bank). We find that many financial metrics have value when assessing credit risk of a bank together with sovereign/country risk assessment. Country risk should be included as sovereign integrity and support is an important driver of bank default. Using only two ratios cannot properly measure the bank credit risk. If agency ratings continue to be permitted for sovereigns, there will also be disconnect with bank risk weights that are based on other drivers. If the Committee is considering taking into account the country of risk as an additional risk driver, clarification would be required for the treatment of subsidiaries that do not report the required risk drivers and that are based in a different country than that of the parent. It will be a challenge for reporting banks to request subject obligor banks to provide CET1 or NPA consistent with Basel requirements unless all jurisdictions require the same information and this information becomes a common disclosure requirement. Imposing on banks to calculate Basel III metrics where this is not required locally would be very burdensome. The lack of these metrics would result in very conservative risk weightings which would impact pricing and resource allocation decisions.

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Another alternative would be more simplified ratios on capital adequacy and NPA are allowed but the risk weight for banks that are not subject to Basel III would be higher than the risk weights for obligors with publicly disclosed information. The Leverage Ratio as an alternate secondary source of weights may also be considered when CET1 is not available or comparable to the Basel III standard. This will avoid the broad brush placement of all non-public banks in the 300% risk weight bucket which is too punitive and not risk sensitive. It would also be helpful for jurisdiction regulators to provide summary data for their banks (on a white-label basis) to either confirm or refute the blanket assumptions that are included in the paper. As an example (on page 8, under question 2, section (iii)), "the committee assumed a LGD of 45% consistent with the Foundation IRB and maturity of 2.5 years". It is also important to consider how the implications of the proposals might shift investments/exposures to banks by Canadian non- D-SIBs. Specifically, would non-D-SIBs be incented to either invest more funds with Canadian D-SIBs or invest them with non-federally regulated entities (i.e. credit unions, ATB Financial, etc.). And if so, how does this impact systemic risk across the Canadian financial services sector? In the case of both credit unions and ATB Financial, it is not possible to calculate a CET1 ratio as they do not have common equity.
(2.2) Exposures to corporates (p. 10)
We believe that external ratings where available for corporates provide a good level of risk sensitivity that allows banks to rely on them. Ratings reflect a corporate entity's most recent financial fundamentals whereas the use of annual financial statements, as suggested by the Committee, would reduce the risk based sensitivity being sought for improving the standardized approach. We suggest that as allowed by the jurisdiction, external ratings should be employed where available for a corporate. Where not available, a slotting approach (high/low investment grade; high/low non-investment grade; watch list/default) based on a bank's master rating scale, potentially incorporating or supplemented by the proposed new risk drivers once they are calibrated to local and industry circumstances through an objective and transparent market indicator, could be used where ratings are not available or allowed. We have also provided some alternative suggestions below under Q5. We have concerns with different aspects of the proposals for Corporate exposures including: • The flat 45% LGD assumption overstates many smaller firms' LGD as they provide physical collateral that is not eligible under credit risk mitigation. • The risk weight for Corporates is based on their leverage (Assets/Equity) and revenues. If either of these measures are unavailable, then the risk weight is set at 300%. We do not believe that any bank that has credit exposure to funds would have these measures, and if they did we do not believe they would be meaningful. The risk weight treatment for funds probably needs a different approach.

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- The treatment for SMEs and specialty industries (funds, insurance, credit unions etc.) needs to be reviewed and redefined.
- Risk mitigation, and debt vs. corporate loan exposures are not addressed.

Additionally, we seek clarification of the following:

- The risk-weighting of institutional funds. Corporate and fund risk are quite different. How will revenue be defined for a fund? Would it be income, net subscriptions, or net asset value increase? The current calibration appears to favour larger funds. We suggest there is likely a need for a new category to deal with relatively stable funds, based on leverage and asset size vs. revenue.
- We would suggest a clear definition of revenue. For instance, is it total revenue before extraordinary items?
- Section 2.2.1 (ii) on page 11 mentions that to calculate revenue and leverage, banks could use the obligor's stated accounts when audited accounts are not available and that these stated accounts should be subject to appropriate verification and due diligence. ''Appropriate verification and due diligence'' should be clarified.
- Further clarification is needed on the consistency of the definition of Corporate exposures between the proposed standardized approach (Annex 1 paragraph 20) and the Basel II IRB approach (Basel II paragraph 218).

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? (p. 12)

We have the following comments/concerns regarding the use of the two proposed risk drivers for corporate exposures:

1. We think using only revenue and leverage is too limited and is a misrepresentation of credit risk. Corporate exposures are driven by many more factors such as industry and region. These factors, along with the financial factors such as revenue and leverage, are used extensively for credit rating analysis in the IRB approach. By removing the role of external credit ratings, we will lose the risk sensitivity to these factors.
2. Replacing the credit ratings with the proposed risk drivers simply shifts the mechanistic reliance on ratings to mechanistic reliance on those two measures, which arguably have much less information and are simplistic. The use of the new drivers does not increase the risk sensitivity.
3. The two ratios suggested fail to differentiate between different types of business (i.e. Agriculture/Service/Manufacturing). These ratios vary greatly between different sectors. Ratios may also not be available or stored in information systems for smaller corporates. This would automatically penalize the risk weight associated with unrated corporates.
4. It is very difficult to develop 2-ratio metrics that works for all corporates around the globe due to material differences of industry, jurisdiction, accounting practices, foreign exchange volatility and numerous company-specific issues (e.g. significant ratio changes in their latest reporting or that are expected due to an acquisition). One of the key issues will be different accounting standards by jurisdiction that can result in differences in calculated leverage ratios (or other financial ratios) that are not reflective of differences in risks.

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5. Selected risk drivers (Revenue and Leverage) for Corporate exposures could be volatile from quarter to quarter, causing instability in risk weight measurement. 6. Using revenue as one of the drivers for RWA may penalize firms in developing countries while benefiting larger firms who tend to have large systematic risk. 7. Leverage can vary significantly and systematically across jurisdictions and sectors. While obligors in some industries (e.g. regulated utilities) typically perform well with highly leveraged balance sheets, in other industries this is a sign of deteriorating credit quality. 8. The proposed 300% risk weight for corporate borrowers that have not provided its financial information is punitive. Financial statements are not requested (or may not be provided by the borrower) for a number of reasons including strength of collateral (for example liquid secured facilities), type of borrower (small business, agriculture) or nature of the loan. 9. The BCBS admits that ratings may be good predictors of corporate defaults but only a small proportion of corporate exposures are rated (p 10). Why not then maintain the ratings-based approach for those that are rated and find a proxy for ratings (e.g. a bank's master rating scale which is calibrated to external ratings) for unrated exposures. 10. A discussion of liquidity metrics is conspicuously absent from this section and should also be considered in the selection of appropriate risk drivers. We offer the following suggestions for improvement: 1. Having two measurement options, one being external ratings and the other being a slotting approach based on a banks master rating scale (which may incorporate the proposed risk drivers) if ratings are not available. Any such use of risk drivers requires that they are calibrated to local and industry circumstances through an objective and transparent market indicator. 2. Exploring the use of banks' internal rating processes which would be brought together in a way to construct a set of standardized risk weights for individual obligors. 3. If it is necessary to choose 2 risk drivers, leverage and debt service coverage could be another alternative pair. All else being equal, revenue may further differentiate relative risk but is not necessarily conclusive and will unfairly penalize smaller borrowers if revenue effectively carries a 50% risk weight. 4. Other leverage measures such as Total Debt/Tangible Equity, Debt/EBITDA can also be considered. Other risk drivers that could reflect credit risk would be operating efficiency or liquidity ratios. Revenue and leverage alone we believe do not cover a company's ability to meet its obligations over the medium/long-term. 5. Generally, off-balance sheet leverage should be included in the calculation of leverage especially for larger entities and equity should exclude intangibles. This however will result in more complex calculation requirements that may not be readily available for most banks. The requirement for inclusion where the obligor's auditors considers the exposures to be material also requires more clarification. Most material off-balance sheet items are required to be reflected in financial statements. Capturing this additional data requirement will be burdensome and provide little additional benefit to risk sensitivity. A materiality threshold on inclusion of off-balance sheet exposures is preferred.

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Q6. Do respondents have views on the appropriateness of the proposed treatment, especially with regard to SMEs? And about the more lenient treatment for start-up companies? (p. 12)

The objective of the proposed standard should be to keep financial institutions appropriately capitalized and not influence policy or lending decisions through favourable or unfavourable treatment of specific exposures. While it is impractical to identify and calibrate risk drivers that will be internationally applicable (particularly for SMEs), as a longer term exercise we support the continued investigation into risk drivers for SMEs and other exposures.

The proposed risk weights for corporates, as they apply to smaller firms, at first glance seems to be counter-intuitive with respect to the IRB corporate SME capital treatment. Specifically for a corporate and a corporate SME with the same PD, LGD and maturity, the SME size adjustment factor results in a more favorable capital treatment for the SME. In addition, SME portfolios are typically collateralized and collateral is not eligible under the mitigation rules. The floor of 60% for corporate is also too high for some high quality companies (e.g. high investment grade equivalent), which is not reasonably comparable with IRB measures.

The size of borrower generally may be one of several measures used to assess the relative credit riskiness of a borrower. If used as a primary driver, i.e. 50% weight in this proposal, the range of risk weights from 90% to 130% is probably not sufficiently sensitive, resulting in over or under estimation. For example, given a senior secured exposure to a SME obligor with 50bps PD, 35% LGD, 3yr maturity, the risk weight is 60%; for a watch list obligor with PD 10%, the risk weight increases to 155%.

We suggest possible alternative drivers for SMEs including the Current Ratio and Debt/Interest Coverage ratios. The proposed drivers of revenue and leverage are also not appropriate for Non-Bank Financial Institution (NBFI) type corporate exposure. NBFI corporate should be carved out with at least sub-categories of Funds, Insurance and Other. NAV and leverage could be used as risk drivers for funds, and a profitability ratio and leverage for insurance. Based on the proposals, additional factors should be considered for SMEs so as to not penalize this segment which could lead to unintended consequences such as restrictive lending which could also adversely affect the economy. Consideration should be given to developing a separate risk-weight table for SMEs.

Intuitively the risk of default for start-ups is probably higher than established companies so the rationale for allowing for a more lenient treatment does not appear to make sense. For start-up companies, though, whether 110% is lenient needs to be viewed on a relative basis. Based on the preliminary risk weights that range from 60% to 130% (taking aside the 300% risk weight), 110% would not be too lenient as the higher 120% and 130% risk weights are for obligors with very high leverage. Generally, there will be some conservative adjustment for start-up companies with no track record that would be applied by most banks in the credit and rating assessment process. Pro-forma financials could be considered for start-ups and the next higher level risk weight may be applied. This alternative however will not be simple to implement as an additional identifier for start-up companies will need to be captured. The additional cost of implementation may far outweigh the benefits of possibly a 10-20% risk weight difference for a very small population. We believe the risk-weighting for start-ups

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should be 100% to maintain their risk-weighting as under the current framework. We also find that the material jump from 90% -130% to 300% from very high leverage to negative equity is too steep. If the proposed proceeds, we expect that the risk weight levels will be reduced in the final calibration.
Q7. Do respondents think that the risk sensitivity of the proposal can be further increased without introducing excessive complexity? (p. 12)
Introducing risk drivers, albeit in a limited number, becomes a quasi-IRB approach and increases complexity and consistency issues. As mentioned above, while risk driver identification and calibration is a worthwhile objective, it is not practicable in the near term and will take years to develop, calibrate, and implement. Corporate exposures cover various sectors and credit risk drivers can be different. For example, NBFI such as insurance and finance companies are generally larger and so the revenue will in most cases be captured in the highest bucket. Leverage metrics are also different and NBFI are generally more highly levered notwithstanding that default risk may not necessarily be higher. We do appreciate that it is very difficult to develop a metric based on a couple of ratios that can have sufficient granularity to measure different corporate credit risks around the world. We believe, though, that risk sensitivity may be improved with little added complexity. External credit assessments reduce complexity and are more risk sensitive. A separate calibrated risk weight table for funds could also be used using the proposed leverage driver but replacing the revenue driver with fund Net Asset Value (a readily available data point). Industry, country, and measures of delinquency may also be able to increase risk sensitivity with minimum complexity.
Q8. Do respondents agree that introducing the specialised lending category enhances the risk sensitivity of the standardised approach and its alignment with IRB? (p. 13)
The new category for the standardized approach increases the risk weights for specialized lending, such that they are significantly larger than the IRB measures. This would appear to not strengthen the link between standardized and IRB approaches. We also believe that imposing a risk weight floor does not enhance the risk sensitivity There is also no empirical data to apply an additional risk weight floor for specialized lending categories and similar to the treatment of corporate exposures, this does not give benefit to the fact that specialized lending facilities are generally well secured.

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The proposed treatment of specialized lending, in particular real estate secured lending, needs to be further revised and refined. In many specialized lending scenarios, counterparties similar to conventional corporate exposures simply do not exist. Also, for real estate secured lending, a risk driver-based approach incorporating several variables, such as DSC, LTV, Loan-to-Cost, etc., is likely to be more effective if the risk drivers are carefully developed and calibrated to local and industry circumstances.

We also note the following:

- It is unclear as to who the "counterparty' being referred to is in order to assess whether the proposal improves risk sensitivity.
- The specialized lending category will enhance risk sensitivity but also increases complexity.
- Income-producing real estate should have a separate treatment (possible drivers of project DSC and LTV).
- The current standardized approach allows banks to switch between categories based on collateral. There is no sufficient recognition of this in the proposal.

(2.3) Subordinated debt, equity and other capital instruments (p. 13)

The proposed risk weight treatments for equity and capital instruments are too high, and are not reasonably comparable with IRB measures.

Increases in the RW% for sub-debt and preferred shares to 250% is significantly above existing capital requirements based on AIRB models. Sub-debt from strongly-capitalized corporates would be less risky than senior debt of companies with a weak capital/liquidity position. Currently, these exposures are also subject to national discretion including grandfathering and materiality guidelines. Will this continue under the new approach? If this is not permitted, these exposures will be subject to very punitive risk weights which would affect investment decisions.

(2.4) Retail portfolio (p. 13)

Banks should not be required to aggregate exposures to individuals. This is inconsistent with the AIRB approach for retail. The threshold of 0.2% in relation to diversification is also unnecessary. In various jurisdictions aggregate exposures to a consumer including exposures considered 'other retail' may exceed the 1 million Euro limit though these same exposures would be considered as retail for AIRB. In general the asset classes for standardized and AIRB approaches should be aligned.

Furthermore, as a general comment, the proposed calibrations are such that the balance of risk-adjusted performance will be tipped heavily in favour of the regulatory retail category which attracts a flat 75% across a diverse mix of consumer lending. This will incent certain banks to

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scale back real estate secured lending in favour of higher risk and more volatile businesses such as credit cards, student loans, and personal investment loans. A more risk-sensitive and granular methodology is recommended in order to restore the balance of risk-adjusted performance and allow banks to continue with their current asset mix.
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? (p. 14)
There are several simple ways to increase risk-sensitivity of the regulatory retail exposures treatment. We recommend a differentiation between secured and unsecured exposures. We believe that the current 75% SA risk weight should continue to be applied for the rating of unsecured retail exposures. However, we believe that a materially lower risk weight should be applied for the secured part of any retail exposures based on the value of collateral at inception, which should be objectively determined. For future consideration and in order to make the framework more risk sensitive, we also propose that the following secondary factors could be considered: delinquency, utilization, term, product type, and LTV. Empirical evidence confirms that all these drivers provide a meaningful differentiation of risk. These drivers should be available for most jurisdictions and at most financial institutions. In addition to risk sensitivity, the incorporation of the secondary factors corrects the potential misalignment of incentives that could otherwise result from the increase of CCF for unconditionally cancellable exposures from 0% to 10% proposed by the Committee. This is illustrated below. Consider a customer who only uses 10% of their available credit cards limit, and has not been delinquent in the past year on any credit card obligation. Empirical evidence shows that the probability of default for such a customer is significantly lower than for one using 100% of their credit limit and previously delinquent. Yet the first customer would have Standardized RWA equal (10 + 90 x 0.1) x 0.75 / 10 = 142.5% of their outstanding balance. By contrast, the second customer, who already uses 100% of their available credit cards limit, would have no undrawn limit and as such, Standardized RWA at only 75% of the outstanding balance.
(2.5) Claims secured by real estate (p. 14)
• The definition of residential real estate (paragraph 36) is unduly complex and does not align with the AIRB definition. Additionally the criteria may not reflect industry standards for credit risk evaluation.

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• The proposed risk weights do not align with the capital neutral position of the Committee. Risk weights for mortgages would be much higher than the current 35% for exposures <80% LTV. • We do not consider it appropriate to consider commercial real estate exposure as an unsecured exposure.
Q10. Do respondents agree that LTV and/or DSC ratios (as defined in Annex 1 paragraphs 40 and 41) have sufficient predictive power of loan default and/or loss incurred for exposures secured on residential real estate? (p. 16)
We agree that LTV has sufficient predictive power of loan loss, and a substantial (but not sufficient) predictive power of loan default. By contrast, the DSC ratio would only have limited predictive power at loan origination. Banks do not generally request borrower income information after granting credit. DSC has some predictive power of loan default, but its predictive power is less than for LTV or other risk drivers. This may be due to the fact that as part of prudent mortgage adjudication, the banks already verify that the customers have the means to re-pay their mortgage, independent of the performance of the property. Once this is confirmed, a lower or higher DSC ratio no longer provides significant risk differentiation among approved and funded mortgages. We offer further comments below on the LTV and DSC ratios. **LTV comments:** • This is a predictive loss measure if the valuations are updated as market conditions change. The proposal to keep the value constant at origination will not achieve risk sensitivity. • Predictive power of LTV varies across jurisdictions with varying legal and tax regimes (e.g. US foreclosure laws vs. Canadian laws) and property price volatility histories. One grid for all jurisdictions does not recognize the country-specific risk profiles. • LTV also becomes less relevant in jurisdictions with longer-term mortgages as re-financing is not an issue (collateral value still is). In Canada, mortgage terms are generally 5 years but other jurisdictions may have 20 year mortgages. • Valuation standards as currently drafted (i.e. prudent valuation based on an independent valuation that does not need to be a 3rd party appraiser) provides flexibility but will be subject to inconsistent practices and valuation, which would not meet the comparability objective. • Operational requirements such as an assessment of property values through the use of indexes, or "other loans with liens of equal or higher ranking than the bank's lien'' will be burdensome to implement. The proposed standard also introduces the burden of retaining information of other liens against the property that may not presently be available. • LTV would need to be more defined than in the proposed standard. **DSC comments:** • Presently, there is no standard mechanism to estimate all financial obligations of a borrower. • Definition applied to calculate the ratio will need to be standardized and jurisdictional differences again will need to be reconciled.

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Definitions and calculations differ between financial institutions and across jurisdictions. Each bank will have its own established policies. • Not updating the metric will not achieve risk sensitivity especially given the term of these exposures may be long-dated. Detailed LTV and DSC information will also be challenging for portfolios presently subject to Standardized (non-AIRB).
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.) (p. 16)
Although we understand the practicality of using LTV and DSC based on values at the time of origination, both property values and consumer servicing capacity will vary significantly due to changing market conditions and borrower employment status, age, etc. That being said it is much more impractical to use other indicators which may not be available at the borrower level, such as debt-to-income. We also raise the following questions and concerns in relation to LTV and DSC below: • What are the requirements for independent valuation? Do they delineate model-based valuations from physical appraisals? • The Committee proposes calculating the LTV based on the total exposure on the property including undrawn commitments. Including undrawn commitments may reduce the risk-sensitivity that the Committee has attempted to introduce. Additionally, the standard should more clearly define when and how the appraisal value of the property can be adjusted from the value at origination. More clarity is also needed in the acceptable appraisal methods and whether estimations can be used. We further ask the Committee to consider using an indexed appraisal value rather than the value at origination, as it would more accurately reflect the credit risk of certain exposures. Using LTV or indexed LTV may be difficult to standardize across jurisdictions and financial institutions. Jurisdiction specific thresholds should therefore be considered. • The Committee proposes using after-tax income in the calculation of the DSC ratio. Presently, the ratio is calculated using gross (pre-tax) income in Canada. Net income would be difficult to estimate and apply consistently across financial institutions and jurisdictions. Payments can also be defined in many different ways (% of balance, actual payment, minimum payment etc.) making the use of this ratio impractical. Additionally, the use of the ratio as measured at origination does not seem to accomplish the goal of increasing the risk-sensitivity of the approach since mortgage exposures can remain on book for many years after origination. • It may be difficult to ensure all exposures secured by the same property are risk-weighted the same (multiple mortgages, lines of credit, etc.) • It will be difficult to ensure that adjustments to the calculation of DSC for variable rate loans are fair and consistent across jurisdictions. • How would the mortgages that are renewed be treated? Would they be viewed as "newly-originated" mortgages with new ratios?

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Q12. Do respondents have views on whether the use of a fixed threshold for the DSC ratio is an appropriate way for differentiating risks and ensuring comparability across jurisdictions? If not, what reasonably simple alternatives or modifications would respondents propose while maintaining consistent outcomes? (p. 16)
We do not believe that using a fixed threshold for DSC is appropriate. Different jurisdictions have very different tax regimes, social benefits, and structure of households' balance sheets. Moreover, the DSC calculation differs across jurisdictions and often across banks in the same jurisdiction. As a result, the same numerical value of the DSC ratio may correspond to very different levels of the customers' indebtedness across jurisdictions and across banks. This inability to come up with a consistent DSC ratio threshold further highlights the inappropriateness of using DSC as a risk driver across jurisdictions and banks. The cost of collecting and maintaining DSC information should also not be underestimated for less-advanced financial institutions. Alternatively, a well-defined LTV could, after further investigation and calibration over the next few years, be used in combination with other general retail risk drivers such as delinquency, utilization/proportion of loan repaid, and product type in order to increase risk sensitivity of the approach if LTV is found to be insufficient.
Q13. Do respondents propose any alternative/additional risk drivers for the Committee's consideration in order to improve the risk sensitivity in this approach without unduly increasing complexity? (p. 17)
For the rating of residential real estate exposures, we suggest the use of an internationally agreed global LTV metric that would be calibrated to local circumstances based on local housing market conditions. We recommend this process be done in an objective, fact-based, and transparent manner. We believe this would be different from national discretion as we suggest that the global metric and calibration process be subject to rules set by the BCBS and also subject to BCBS review similar to the RCAP.
Q14. Which of the two options above is viewed as the most suitable for determining the risk-weight treatment for exposures secured on commercial real estate? (p. 17)
We believe that Option A is completely inappropriate and not based on Canadian experience when combined with appropriate risk management and controls. Option B also has significant weaknesses. Under Option A, credit quality is the only consideration while under Option B, the focus is on the value of collateral in relation to the outstanding amount of the loan. We believe that it is important for both credit quality and collateral to be considered and there are no options that offer this possibility.

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Option A is focusing on counterparty default risk and assumes recovery on the real estate is similar to unsecured exposures. The treatment of commercial real estate as unsecured with a maximum risk weight of 300% would promote the reduction of lending to commercial borrowers or increase the interest rate on funds borrowed. As a suggested improvement, consideration should be given that based on an LTV threshold, the corresponding unsecured corporate risk weight would be reduced by a fixed %. Option B is focusing on expected recovery based on LTV. Given our earlier comments on LTV, this risk factor may also not be the best choice for risk weight measurement. In addition the floor of 75% risk weight under Option B is too high, and not reasonably comparable with IRB measures. The appropriateness will ultimately depend on the RW% levels. Under both options, the same issues on risk drivers noted in responses to other questions apply. What is the Committee's rationale for using only 1 risk driver for Commercial real estate vs. 2 risk drivers for Residential real estate? Based on the proposed definitions, i.e. primary source of repayment is not from income generated by the real estate collateral, the contemplated CRE would be mostly owner-occupied real estate. The risk weights for exposures secured by commercial real estate are a very narrow range and there is also no consideration for the nature of the loan (e.g. real estate development, income-producing real estate, owner-occupied) or the quality of the collateral (e.g. land vs income-producing, residential, retail, office, etc.). Rather than having to choose between two options, one of which is more along the "PD" dimension and the other "LGD", the final table should take both into consideration as this is aligned with the bank's internal assessment of risk.
Q15. What other options might prudently increase the risk sensitivity of the commercial real estate treatment without unduly increasing complexity? (p. 17)
We suggest using some Real Estate market indicator in individual countries/regions (the real estate market in different jurisdictions could be very different at the same point of time). Consideration should also be given to the nature of the loan and the quality of the underlying real estate. Please also refer to our responses to Q13 & Q14 above.
(2.6) Risk weight add-on for exposures with currency mismatch (p. 17)

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Q16. Do respondents agree that a risk weight add-on should be applied to only retail exposures and exposures secured by residential real estate? What are other options for addressing this risk in a simple manner? (p. 18)
We agree that the add-on should be limited to retail exposures given the borrower is likely not hedging these exposures. However, consideration should be given to ensuring the add-on factor is lower for better rated currencies. This would provide for more risk-sensitivity.
(2.7) Off-balance sheet exposures (p. 18)
Proposed revisions to the CCF for commitments with maturity greater or less than a year (50% CCF, 20% CCF) to a 75% CCF will require banks to hold substantially more capital. We believe the current differentiation based on maturity provides sufficient risk sensitivity. We would like to understand the basis for using 10% for unconditionally or automatically cancelable commitments. Is this appropriate vs. historical experience and/or our ability/willingness to withdraw commitment? We would like to understand the support for the proposed change and in particular why it is reasonable for the different types of exposures affected by the change. We note that usage of certain facilities may decline under stress and evidence should be considered to ensure that the change is appropriate for all classes of cancellable exposures.
Q17. Do respondents consider the categories for which a CCF is applied under the standardised approach to be adequately defined? (p. 19)
Greater differentiation in categories could allow for better risk sensitivity. We would welcome more differentiation if it would result in lower risk-weighting of certain off-balance sheet items. Additionally, retail categories LOC, Credit Card, and HELOC should be explicitly included as categories under the revised standardized approach, since the draw-down on retail exposures is difficult to compare with highly monitored commercial/corporate exposures. Commitments with future draw-downs subject to certain conditions to be met by the obligor should also be covered. As noted above, we also find the proposal to increase the risk weighting from "20% and 50%" to "75%" in Table 1 to be very punitive. Commitment to which the CCF is applied should also be clarified. Is Commitment defined as: a) Bank issued commitment letter to customer, but customer has not accepted; or b) Bank issued commitment letter to customer and customer has accepted; or c) Bank issued commitment letter to customer and customer has accepted and loan is legally closed and available for draw-down.

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We also seek clarification on the following items:

- For "unconditionally cancellable at any time by the bank without prior notice", could this be further clarified as to whether a short notice period in a matter of days would qualify?
- Unconditionally cancellable as currently used in the existing standard may be interpreted differently by different financial institutions. We would suggest greater clarity in the definition of this term.
- Revolving retail exposures (credit cards, lines of credit, overdrafts) are generally treated as "unconditionally cancellable" although some banks and some regulators might say that these exposures are not unconditionally cancellable. Since this distinction would have a huge impact on Standardized RWA (10% CCF vs 75% CCF), we recommend that you give clear guidance on how to treat revolving retail exposures.
- Does the BCBS expect to align the CCFs for Leverage on these new CCFs?

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. (p. 19)

We agree in principle with the Committee's proposal to review the CCF for unconditionally cancellable commitments for Retail exposures and Retail Mortgages (HELOC), however we note that certain types of credit facilities may be used differently under stress. We seek clarification on the proposed 10% CCF and the resulting capital charge for unused facilities as they may be disproportionate to the underlying risk.

In particular this would better align the standardized approach treatment with the Advanced IRB approach, where CCF is estimated based on the historically observed additional drawings prior to default, which are not all zero.

However in order to accurately reflect the true risk of these commitments, not only their CCF but also their risk weight under the standardized approach should be adjusted to better align with those under the Advanced IRB approach. Otherwise, the risk weights for the revolving retail exposures (including both their drawn and undrawn portions) as a percentage of their outstanding balances would be misaligned with the actual risk of these exposures, as demonstrated by the following example.

Consider a customer who only uses 10% of their available credit card limit, and has not been delinquent in the past year on any credit card obligation. Empirical evidence shows that the probability of default for such a customer is significantly lower than for one using 100% of their credit limit and previously delinquent. Yet the first customer would have Standardized RWA equal (10 + 90 x 0.1) x 0.75 / 10 = 142.5% of their outstanding credit card balance. By contrast, the second customer, who already uses 100% of their available credit card limit, would have no undrawn limit and as such, Standardized RWA at only 75% of the outstanding balance.

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Thus the reluctance to recognize a much lower credit risk of the first customer in the Standardized risk weight could potentially create misaligned incentives for the banks, as well as the standardized outcomes contradicting the AIRB approach, which assigns a much lower risk weight to the first customer. There are broadly two simple ways to remediate this misalignment. 1. In our response to Q9 we suggest simple ways for future consideration to recognize lower Standardized risk weights for the retail customers who have a deeper relationship with the Bank, an established credit, or lower credit risk as evidenced by their lack of previous credit delinquencies and lower utilization of available credit limit on revolving exposures. This will have an added benefit of assigning appropriately lower standardized risk weights not only to the drawn but also to the committed undrawn exposures to these customers (after the 10% Credit Conversion Factor proposed by the Committee). Therefore the overall Standardized RWA for revolving retail exposures, expressed as a percentage of their outstanding balances, will be directionally aligned with their relative riskiness based on the empirical evidence, and with their AIRB risk weights. 2. An even simpler way to remediate this misalignment would be to directly recognize a lower risk weight for revolving retail exposures (including HELOCs) both the drawn and undrawn portions, where the utilization of available credit limit (i.e. the drawn portion as a percentage of credit limit) is low. It is well known that a dormant credit card account, which hasn't had any outstanding balance for the last year, has an extremely low probability to draw a balance and default on that balance next year. Similarly, a credit card account with a zero or low utilization of the available credit limit has a very low probability to default next year. By contrast, an account utilizing more than 90% of its available credit limit has a higher probability to default. Assigning appropriately low standardized risk weights for low-utilization accounts (including both the drawn and the undrawn portions after the 10% CCF) will accurately reflect their relative riskiness and will align with the Advanced IRB outcomes for these exposures.
(2.8) Past-due loans (p. 19)
Q19. What are respondents' views on the alternative treatments currently envisaged for past-due loans? (p. 19)
We agree with the Committee that risk weights should reflect the level of provisions. An add-on which would vary based on a function of the amount of provisions would appear to be more risk-sensitive.

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We suggest the risk weight for past-due loans be based on the higher of a flat risk weight and a risk weight based on the sum of provisions and an add-on. A flat risk weight would ensure that there is a minimum capital level especially for cases where provisions may not have been assessed yet or may be insufficient. The latter component of the calculation recognizes that banks have already established provisions and add-on accounts for uncertainty in the provisioning. An add-on that varies with provisions is reasonable.
(2.9) Exposures to multilateral development banks (p. 19)
We are concerned that the criteria for identifying "qualifying MDBs" are vague and create opportunities for inconsistent application of risk weights between banks. We suggest that the BCBS maintain a list of "qualifying MDBs", similar to the approach currently taken for "highly rated MDBs".
Q20. Do respondents agree with the proposed treatment for MDBs? (p. 19)
We believe that the proposed risk weight treatment for MDBs is reasonable. We feel the MDBs should be considered a unique subset of corporates while retaining the current risk weights. For consistency, the regulations need to be clear that the 0% preferential treatment applies under the IRB framework.
(2.10) Other assets (p. 20)
We need to understand what exposures would be classified as "Other Assets" or "Other Credit-Risk-weighted Assets". Using the 100% risk weight for all categories does not seem appropriate. The current Basel III framework which risk-weights other assets at 0% (cash & gold) and 20% (cheques) seems more appropriate. Moreover, we would reference footnote 32 of BCBS 2006 § 81 which states: However, at national discretion, gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities can be treated as cash and therefore risk-weighted at 0%. In addition, cash items in the process of collection can be risk-weighted at 20%.

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Q21. What exposures would be classified under “Other assets”? Is a 100% risk weight appropriate? (Please provide evidence where possible). (p. 20)
We suggest that the classification of items as other assets be consistent with IFRS accounting rules. We believe that the Other Assets category should be similar to what we have today. We will need further clarification of securitization exposure rules because the new standardized guidelines do not come into force until 2018. Until then, would these exposures be subject to the proposed 100% risk weight? We do believe that the proposed 100% risk weight for the residual “other assets” class is not appropriate for all types of other assets. The 100% risk weight appears to be a legacy of Basel I and we believe this should be revisited. For example, lower risk weights should be applied for certain asset categories such as cheques in transit and accrued interest. Items in transit, currently risk weighted at 20%, might also be impacted by the changes to the risk-weighting of banks. We also note that the Exposure draft on lease accounting is expected to bring all leased assets (i.e. rental properties) on the bank's balance sheet. Applying a 100% risk weight for such assets would be excessively punitive.
Section 3: Proposed revisions to the credit risk mitigation framework for exposures risk-weighted under the standardised approach (p. 20)
We are generally comfortable with the proposals, although we have some specific observations. We note that the BCBS previously published a standard describing the new Standardized Approach for Counterparty Credit Risk (SA-CCR) for SFTs and OTC derivatives. It is clear, from the latest document, that the SA-CCR is part of the standardized approach and would therefore contribute to the capital floor. This means that Banks must be able to determine the SA-CCR for both capital floor and regulatory Single Name Exposure purposes. Obtaining approval to use IMM for OTC derivatives and SFT will <u>not</u> eliminate the need to be able to determine the SA-CCR.
(3.1) Approaches to be excluded (p. 21)
(3.2) Eligible financial collateral (p. 22)

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The requirement to determine the RW% for each Corporate and Bank collateral issuer, based on financial ratios, could require major investment to obtain and process this data. The use of agency ratings, as per current practice, is much more efficient. It is worth noting, however, that moving away from a rating-based approach allows for securities for which there is no rating, to be considered as collateral.
Q22. What are respondents' views on the above alternative ways to define eligible financial collateral? (p. 22)
Even though reliance on external ratings may not be warranted, the alternatives suggested may not be feasible to implement for individual financial institutions. Given the substantial volume of financial collateral, it will not be feasible to complete the necessary due diligence to assess the risk of default and if full/timely repayment is expected for each issuer of the financial collateral. The concept of "investment grade" appears reasonable but we believe that it would be difficult to implement operationally unless it is linked to external ratings. If agency ratings are replaced, any alternative approach will need to be aligned with the approach for determining risk weights for exposures to like issuers/counterparties in other portfolios.
Q23. What are respondents' views on the recalibrated supervisory haircuts shown in Table 4? What are respondents' views on how to eliminate references to ratings from the supervisory haircuts table? What could be the implications of eliminating references to external ratings? (p. 24)
We are supportive of more granular maturity buckets for supervisory haircuts in Table 4 as this would reflect inherent risk better. We also prefer the ratings-based table over the issuer/RW-based table. The latter seems to be less risk sensitive than the ratings-based approach and would require additional work to build out the infrastructure with little apparent benefit. We do question whether the increased haircuts due to recalibration in issuer rating categories of AAA and Main index equities are required. With respect to ratings, we would ask the Committee to re-consider removing external ratings as this makes the evaluation more complex and could lead to greater variability in RWA. We also ask the Committee to consider using similar criteria to eligible guarantors under the IRB approach so that unsuitable guarantors are excluded.

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(3.3) Eligible credit protection providers (p. 24)
Q24. What are respondents' views on the proposed corporate guarantor eligibility criteria? (p. 25)
The key determinant for guarantor eligibility should be based on the absence of any economic relationship or interdependence between the borrower and guarantor and if there is true economic benefit expected from the guarantee. Thus, eligible guarantors should not be limited to non-corporates. Could the BCBS also clarify what the "economic relationship" would be defined as when considering the relationship between the borrower and the corporate guarantor.
(3.4) Treatment of credit derivatives (p. 25)
We believe that the proposed treatment will increase the capital for SFTs on sovereign/PSE securities with core market participants; QIS could be helpful in that regard.
(3.5) Treatment of repo and OTC derivative transactions (p. 25)
We conceptually agree with the 0% risk weight and 0% haircut for SFTs with "core market participants" as the involvement of these participants may not necessarily reflect the risk inherent in these transactions and warrant a change.
Section 4: Quantitative impact study (p. 25)

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Annex 1 Proposals on exposure classes and credit risk mitigation (p. 27)
We realize that the ratings provided in the consultative document are preliminary and are subject to change but we would like to draw your attention to some anomalies in RWA rates of Banks (Page 31) and Corporates (Page 33) with an example below: Let us Consider a Bank with CET1 ratio = 9.4% (9.5% > CET1 ratio ≥ 7%- page 31) but Net NPA Ratio say 3.01% (3% < Net NPA ratio- page 33) and it would attract 100% RWA. On the other hand a corporate with Revenue ≤ €5m and Leverage ratio of 1x–3x also gets RWA rate of 100% (page 33) which seems to be unfair. Again the table on page 33 seems to be opposite of current Basel III rules. Under Basel III rules smaller firms gets a benefit due to a firm-size adjustment, whereas this table on page 33 gives benefit only for larger firms.