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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<sup>1</sup> Comments on the BCBS second consultative document:  
*Revisions to the Standardised Approach for credit risk***

We thank you for the opportunity to provide comments on the BCBS's second consultative document, *Revisions to the Standardised Approach for credit risk* ("consultative document"). In addition, we appreciated the opportunity to participate in the industry outreach session on February 17<sup>th</sup> that was organized by the Task Force on Standardised Approaches (TFSA).

In general, we welcome the revisions to the original proposals which have addressed some of our concerns related to risk sensitivity. For example, we are pleased with the BCBS's decision to allow the use of external credit ratings for bank and corporate exposures in jurisdictions that allow for the use of such ratings for regulatory purposes.

However, we continue to be quite concerned with how much higher the required capital under the proposed standardized approach could be vs. our current capital requirements, the majority of which are calculated under advanced approaches. We find it difficult to project how an application of a floor based on the proposed standardized risk weights would not result in a material increase in required capital for the Canadian banks. Not only would such a result contravene the Committee's stated position that "increasing overall capital requirements under the Standardized Approach for credit risk is not an objective of the Committee; rather, capital requirements should be commensurate with the underlying risk", it would be an unreasonable outcome if a group of banks, that collectively are afforded some of the highest credit ratings globally, were required to hold materially higher capital due to risk insensitive standardized risk weights.

We are concerned about the potential negative consequences of driving Canadian banks further out on the risk curve to seek acceptable returns when faced with an increase in capital. This would not be a desired outcome from a regulatory perspective. Specifically, we have significant concerns over the risk insensitive flat risk-weights that are proposed for certain exposure

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<sup>1</sup> The Canadian Bankers Association works on behalf of 59 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](http://www.cba.ca).

classes, such as regulatory retail exposures, and unrated corporate exposures in addition to other exposure classes. Our other major area of concern with this second consultative document relates to the proposed credit conversion factors for off-balance sheet exposures.

Additionally, we have provided our views on the due diligence requirement for bank and corporate exposures, national flexibility and risk weighting for residential and commercial real estate exposures, the use of standardized approaches for a capital floor, and implementation. Detailed comments on these and other areas are also included in the attached appendix.

### **Risk sensitivity**

In general, we are concerned that the proposed framework is too focussed on Probability of Default (PD) without reflecting Loss Given Default (LGD) or the type and quality of collateral. Furthermore, we believe that increased granularity is necessary for the risk weight buckets when moving between categories for the different exposures. We provide below our views on certain exposure classes.

#### *Regulatory retail exposures*

Given the BCBS's decision to re-introduce external credit ratings for bank and corporate exposures, we believe that risk sensitivity should also be enhanced for regulatory retail exposures, which for many banks represent a large percentage of their credit exposure. We are concerned that a flat risk weight of 75% was maintained for all retail exposures from the first consultative document, and we suggest a more risk sensitive approach. Specifically we suggest that a range of commonly recognized risk characteristics be established that identify lower-risk retail credit exposures. Examples of such criteria include prime and super-prime (vs. near-prime and sub-prime) credit quality as identified in the Basel Securitisation Framework; revolving retail credit customers identified as transactors (vs. revolvers); customers with an established relationship with the bank, in particular with an established deposit relationship; and collateralized retail exposures with LTV based on prudent criteria not exceeding 65%. Regulatory retail exposures satisfying any of these criteria would qualify for lower risk weights, as appropriate, where the national supervisor has comfort that there is sufficient loss history supporting this lower risk weight. (One key data point that can be used to substantiate this lower risk weight is the default and loss history for the respective segment maintained by the banks within each jurisdiction that report RWA under the Advanced IRB Approach).

#### *Corporate Exposures*

For jurisdictions that allow the use of external ratings, we are concerned that greater risk sensitivity will not be achieved for a large number of corporate exposures that are unrated. Such exposures would be assigned a risk weight of 100% which may not be commensurate with the underlying risk and would not provide the risk sensitivity the Committee is seeking. This would be disadvantageous treatment, given that corporate exposures that are investment grade in jurisdictions that do not allow external ratings would be risk-weighted at 75%. For unrated corporates in jurisdictions that allow external ratings, we recommend adoption of the same investment grade/non-investment grade classification to allow for more risk sensitive measurement.

We are also concerned that exposures to low risk funds would be treated as unrated corporates under the proposed framework and be subject to the 100% risk weight. We recommend that regulated and low leverage funds be assigned a lower risk weight to improve risk sensitivity.

We note that the Committee has allowed the use of a preferential risk weight of 85% for Corporate SMEs without an associated requirement of any due diligence or rating nor taking into

account the fact that overall SME default rates may not be lower than that of Corporate Exposures.

#### *Bank Exposures*

We are concerned with the lack of sufficient differentiation in risk weights under the External Credit Risk Assessment Approach (ECRA) for banks. We believe that there should be differentiation in the base risk weights between A+ to A- and BBB+ to BBB- banks. Currently, the risk weights for both buckets are 50% and we recommend changing the risk weight for banks rated A+ to A- to 35%, to reflect the lower risk of highly rated investment grade banks.

For the Standardised Credit Risk Assessment Approach (SCRA), we request greater clarity on the criteria for and the differences between the Grade A, Grade B, and Grade C buckets. Our specific questions are included under section 1.1.1 in the attached appendix. We are also concerned that the basis of the categorization between Grade A, Grade B, and Grade C is operationally burdensome and may not provide the true risk sensitivity desired. The requirement that a counterparty Grade A bank would need to surpass all regulatory minimums and buffers as implemented by its national supervisor would pose significant operational challenges. In particular, we would like to see clarification on whether this requirement would apply to all of the bank's subsidiaries as complete data may not be readily available, depending on the jurisdiction.

#### *Specialized Lending*

We are concerned about the punitive risk-weighting treatment assigned to the separate asset class of specialized lending activities (i.e. project finance, object finance, commodities finance) when an issue-specific external rating is not available or not allowed. We believe a flat risk weight of 120% is overly punitive for what is considered a secured loan in the case of object and commodity finance activities. In the case of project financing, the proposed risk weight of 150% in the pre-operational stage and 100% in the operational stage appears excessive. Banks' due diligence processes would ensure that the project being financed would be able to generate sufficient funds to repay the loan provided. As such, we do not believe a higher risk weight than 100% is required for the specialized lending category given the requirement that sufficient due diligence be undertaken.

#### *Land acquisition, development and construction (ADC) exposures*

We believe that a flat 150% risk weight for ADC exposures is very punitive and disregards that a spectrum of risk profiles exist with ADC exposures. We believe the risk weight assigned should reflect the level of risk related to the type of ADC exposure. We believe a flat risk weight provides banks with the incentive to take on more risk as safer ADC exposures will not attract the same level of yield, but will require the same level of capital.

Instead, the risk weight treatment for ADC exposures should take into account key underwriting attributes to measure the level of risk that the bank is undertaking and the risk weight of the ADC exposures should be adjusted accordingly. For land acquisition exposures, we suggest consideration of the LTV ratio as the most relevant credit attribute. For development and construction exposures, we recommend consideration of the LTV ratio, and pre-sales and pre-leasing as the two most relevant credit attributes. We have provided further details including proposed risk weight tables in the attached appendix.

#### **Off-balance sheet exposures**

The requirement that a Credit Conversion Factor (CCF) must be greater than 0% regardless of the exposure type is overly conservative and is not consistent with the IRB approach. We also believe this does not achieve the goal of correctly quantifying the risk associated with the lending product.

For retail unconditionally cancellable commitments (UCC), the increase in CCF from 10% to 20% contemplated in the second draft of the BCBS's proposal does not reflect the significantly lower underlying default risk and unduly provides increased risk weighting on those individuals who utilize little or none of their credit limit. We find that the majority of unused retail credit limits are in dormant accounts and/or belong to the best credit quality customers. In either case, they have an extremely low probability of default, which is reflected industry wide in their AIRB PD estimates and therefore risk weights. Applying a flat risk weight of 75%, which is an order of magnitude higher than their risk weights under the AIRB approach, coupled with a 20% CCF, would unduly penalize these low-risk revolving retail exposures. The contemplated risk weighting is also at odds with the nature of the current regulations around consumer credit protection. Applying such a rule across the board would ultimately only change the way retail commitment contracts are written and activated, and hence reduce credit limits available to the best credit quality retail customers, and in particular transactors (such as travel credit cards' limits), and/or increase banking fees.

We also believe that the range of 50 – 75% for non-retail UCC is overly conservative as it does not reflect the actual usage ratios of these credit lines and would adversely affect lending and economic growth. Furthermore, the introduction of this approach would mean that there is little to no difference in capital requirements between the cancellable and non-cancellable commitments and the banks will receive very little capital relief from making a commitment cancellable. We would argue that there are good reasons why a commitment is judged to be unconditionally cancellable as it puts the bank in a better position to manage its risks which should be recognized in reduced capital requirements.

For product types that truly allow the bank to cancel uncommitted facilities at any time in practice, we believe that it is reasonable to apply the lower CCF proposed for Retail UCC to non-Retail exposures where there are demonstrated controls and legal rights, monitored with robust internal bank governance processes. Additionally, a lower CCF should be considered for ADC facilities that are subject to stringent conditions precedent such as level of presales or construction completion that are phased in over a longer term horizon.

We believe supervisors should be allowed the flexibility to determine whether unconditionally cancellable facilities are truly cancellable in their jurisdictions and then be allowed to prescribe a risk weight.

We understand that the Committee is conducting further analysis on the appropriate definition and calibration and would appreciate if the Committee can share, for industry's review and further input, the data and studies referenced in support of higher CCFs. We believe that it is possible for the Committee to implement well defined criteria for non-retail UCC to better differentiate facilities that rightfully should qualify for lower CCFs commensurate with the risks.

#### **Due diligence requirement for bank and corporate exposures**

We agree that banks should perform independent internal due diligence analysis and not solely rely on agency ratings for credit decision-making purposes. In Canada, our banks conduct internal assessments and/or have internal rating systems in place and we understand from our regulator, OSFI, that this would satisfy the due diligence requirement.

We are concerned that the due diligence analysis will vary across jurisdictions. As a result, we suggest that formal recognition of rating agencies could be done by the national supervisor with the supervisor publicly disclosing the criteria that these agencies met in order to qualify and in such cases adjustment to the base risk weights would not be required. For example, in Canada,

OSFI has recognized DBRS, Fitch, S&P, and Moody's as acceptable in our Capital Adequacy Requirements (CAR) Guideline. Alternatively, in jurisdictions where this is not the regulator's preference, due diligence could be performed by the banks as a group for each of the major external credit assessment institutions (ECAI) so that a similar level of rigor is applied across jurisdictions, and ratings issued by these eligible ECAIs could be used in the same manner by all banks to ensure comparability.

We further suggest that both increases and decreases to the base risk weights for bank and corporate exposures be permitted as a result of the due diligence analysis and not just increases as suggested in the consultative document. It is important to note that credit rating agencies publish updates to their ratings at certain intervals. New information may arise which suggests a more favourable rating, for example, than what has been published, and we believe this should be allowed to be reflected in regulatory capital calculations.

### **Residential and commercial real estate exposures**

We support the use of the Loan-To-Value (LTV) ratio as a key metric for differentiating between risk weights for real estate exposures. We also welcome the use of operational requirements in the Real Estate exposure class. However, we believe that certain exposures such as residential real estate may have notably different risk characteristics across jurisdictions due to local default experience or jurisdictional specificities, and that it would be appropriate to allow national regulators to set potentially different risk weight requirements which can be lower than the prescribed base risk weights due to varying levels of recourse.

In addition, we have concerns with the difference in the proposed risk weight treatment between income-producing real estate (IPRE) exposures, where repayment is materially dependent on the cash flows generated by the property, and non-IPRE exposures. We believe that it would be clearer from an implementation perspective if a materiality threshold were specified to ensure greater consistency, comparability, and applicability on both a national and international basis. We also believe further clarity should be provided in the document in defining when exposures move from the classification of ADC to IPRE.

We find that the divergence in risk weights between IPRE and non-IPRE to be too great for both residential and commercial exposures. For residential exposures, where operational requirements are met, the risk weights are significantly higher for IPRE, ranging from 70% to 120%, when compared to non-IPRE which have risk-weights of only 25% to 55%. As such, we believe that risk weights for IPRE exposures are too high in absolute terms. For retail, we rely on the borrower's capacity to repay in underwriting, and take a conservative view of property-related income in servicing calculations, and therefore the proposed risk weights for IPRE appear punitive. We also note that unsecured regulatory retail exposures are risk-weighted at 75%; however, secured loans for IPRE with an LTV of 80% are risk-weighted at 90%. We would request that the Committee revisit the IPRE risk-weighting based on the QIS results, and provide the banking industry transparency by making accessible any data and studies behind the proposed risk weights.

We are also concerned that smaller banks will be significantly impacted compared to larger banks as they often have a higher proportion of these types of mortgages on their books. We believe that the proposed changes would hurt the rental market in Canada and make affordable housing less available. Finally, we are also concerned that we may not be able to identify whether a property is IPRE or non-IPRE over the life of the mortgage as the property may be rented out without notification to the bank. The requirement to consistently monitor for a change in status would be difficult to operationalize and would represent a change in market practice.

**Capital floor based on standardized approaches**

The establishment of a floor for IRB banks based on the standardized approach capital requirements is something the CBA continues to disagree with. While we acknowledge that the existing IRB floor, based on Basel I, needs to be replaced as the framework is substantially different from Basel III, we believe that simply imposing a floor based on the standardized approach which is in itself inferior in risk sensitivity compared to the IRB approaches will not accomplish the Committee's stated objectives. We look forward to the opportunity to review and comment on future proposals on the capital floor framework.

**Implementation**

As noted in the consultative document, we appreciate that the Committee "will provide sufficient time for implementation taking into account the range of other reforms that have been, or are due to be, agreed by the Committee". We would stress that implementation timing should not be accelerated as proper calibration of the standardized approach is needed by means of QISs, and banks will also need time to operationalize the new requirements. We would also stress that QISs and proper calibration are very important because of the interaction with capital floors, and the leverage ratio, for example.

We thank you in advance for your consideration of our comments, and would be pleased to have further discussion at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "David Hamel", with a stylized flourish at the end.

Attachment

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

**CBA Comments on BCBS's Second Consultative Document  
'Revisions to the Standardised Approach for credit risk'**

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**CBA Members' Comments and Requests for Clarification**

**Overall Comments and Key Issues**

Capital floor based on standardized approaches

We are encouraged with the Committee's reiteration that *"Increasing overall capital requirements under the SA for credit risk is not an objective of the Committee; rather, capital requirements should be commensurate with the underlying risk."* This objective is especially important for the Committee to reconsider if setting a floor for the A-IRB approach based on a relatively less risk-sensitive and inferior Standardised Approach (SA) is the ultimate goal.

A-IRB banks in Canada have expended commendable efforts and resources to develop robust and risk-sensitive rating systems that align with Basel standards and it would be several steps backwards if a floor that is based on less risk-sensitive measures were to be imposed on A-IRB capital requirements. The floor would effectively penalize the higher quality or lower risk exposures, resulting in undesired consequences in lending practices and portfolio compositions as banks may gravitate towards the higher returns from riskier assets where capital requirements may be the same as lower risk assets. In particular, the SA risk weights that are overly punitive include regulatory retail exposures, and unrated corporate exposures.

While the Committee purports to better align definitions and scope of exposure classes for the SA and A-IRB approaches, we question if the proposed revision will achieve this objective. The proposed SA requires classification of exposures into risk grades such as for Bank and Corporate exposures, and the establishment of a new aggregated Real Estate Exposure class and these developments are not necessarily aligned with A-IRB requirements. The application of the SA approach will increase regulatory burden, resulting in higher capital that is not commensurate with risk and with limited value to A-IRB banks. In the continued assessment of floor implications, we urge the Committee to consider these critical issues as bank resources would be better allocated to continuous improvement of the A-IRB rating system that provides for more risk sensitive and accurate capital determination.

Implementation

The SA should remain simple to adopt and should not require extensive data collection, which could lead to unwanted complexity. Consideration should be given to possible challenges surrounding IT implementation needs in order to capture the required additional data. Therefore, sufficient implementation time is required (we suggest at minimum 2 years).

We believe that some of the proposed modifications would be difficult to implement for smaller banks and do not achieve the goal of increasing risk sensitivity. We are also concerned about the potential negative impacts on other areas such as Leverage and Liquidity. We believe that higher CCF requirements for off-balance sheet will negatively affect banks leverage ratios if the SA rules ultimately are reflected in future updates of the leverage framework.

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**Introduction and Next steps (p. 1-3)**

1. We believe over-reliance on the SA and its premature implementation would be dangerous. The SA's calibration must be carefully tested by means of several QIS and its impact must be understood before implementation. We strongly believe that multiple QIS recalibrations will be required to ensure accuracy.
2. The SA relies on many exposure class qualification criteria, and the RWA varies very significantly based on whether or not the exposures meet the criteria or not. We believe, in many cases, the qualification criteria are vague. Clarification is needed on definitions and classifications (for example IPRE categorization).
3. We believe the SA is overly conservative and, if implemented "as is," will very materially increase capital requirements for many banks. For banks that are in the process of transitioning to A-IRB, the implementation of a punitive SA will also put them in a very awkward position. In addition for banks already A-IRB, expected capital floors based on SA will be overly conservative.

**Section 1: Proposed revisions to the standardised approach for credit risk (p. 3)**

While the current SA is primarily based on external rating, it may be applied in smaller portfolios of A-IRB banks and in jurisdictions with fewer risk management practices and resources at their disposal to develop complex A-IRB models. Although less risk-sensitive than A-IRB, the SA is sufficient in cases where increased analytical costs are difficult to justify. The application of the SA on all portfolios will make external ratings overly important and result in overreliance. The portfolios that are not externally rated will potentially be priced higher by the market or require external ratings in the future. However, we appreciate that the Committee may have difficulty in finding common risk metrics across jurisdictions.

**1.1 Exposures to banks and corporates (p. 3)**

The revised proposal calls for the risk weighting of banks and corporates using external ratings and thus reintroduce those ratings into the risk weight process. The proposal calls for a base risk weight to be determined by the external rating, and to then be subjected to an internal effective challenge process by the bank, which should result in an increased risk weight if warranted. In Canada, our banks conduct internal assessments and/or have internal rating systems in place and we understand that this would satisfy the due diligence requirement. Most often, these procedures include capping the initial rating at the corresponding sovereign rating, and overriding the external rating based on material strengths and weaknesses of some borrower risk characteristics. Often these risk drivers include cash flow, leverage, and liquidity, as well as qualitative factors.



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The potential for inconsistent application of the due diligence requirement across jurisdictions is high and accordingly we offer some suggestions in our cover letter.

**1.1.1 Exposures to banks (p. 4)**

External Credit Risk Assessment Approach (ECRA)

The Committee's requirement that bank ratings do not reflect government support would not be feasible to implement unless rating agencies disclose a separate rating excluding government support. The onus should be on rating agencies to provide standalone bank ratings without implicit or explicit government support. We suggest that the BCBS have discussions with the rating agencies as to the feasibility of providing ratings without sovereign support.

Standardised Credit Risk Assessment Approach (SCRA)

The application of three buckets of due diligence is burdensome and may be impractical due to inconsistent access to the requisite information on regulatory ratios and buffers across banks and their subsidiaries in their various jurisdictions. For example, Grade A (50% RWA) requires the counterparty to exceed the published minimum regulatory requirements (leverage, liquidity, risk-based capital ratios) and buffers (GSIB surcharge, capital conservation and countercyclical capital buffers). The referenced ratios/metrics are not always publically available in all jurisdictions and for all subsidiaries of a single name, and the costs of tracking these data components by jurisdictional requirements will be costly with little capital savings. Similarly, determining Grade C (150%) bucketing based on whether the auditor has provided an adverse audit opinion would be operationally burdensome.

Some smaller banks in certain jurisdictions may also not have the infrastructure to monitor compliance of its banking counterparties with capital, liquidity, and leverage requirements. It may be more appropriate for the BCBS and the local regulators to maintain a list of banks with the most current SCRA ratings. It would be a time consuming process fraught with errors if each of the banks implements its own process to collect the data on regulatory compliance of their counterparty banks.

We also believe that the number of grades is not sufficiently granular and risk weights should be better aligned with those for the ECRA. In particular, the proposed Grade definitions require more clarity and differentiation for application as noted below:

- On p. 5, the criteria stated for Grade B is that "If a counterparty does not meet one or more of the applicable published buffers... a bank would apply a risk weight of 100%...as long as none of the triggers for Grade C is breached", yet the Grade C section indicates that "a bank would apply a Grade C risk weight if any of the triggers below is breached" and breaches include "The bank counterparty has breached any of the published and binding min regulatory requirements..."
- On p. 29, the criteria stated for Grade A is that "a counterparty bank...must exceed the published minimum regulatory requirements and buffers..." while for Grade B, "a counterparty bank must meet the published minimum regulatory requirements..." In practice, most banks will likely exceed the minimum regulatory requirements as opposed to meeting the exact minimum requirements that may

### **CBA Members' Comments and Requests for Clarification**

be suggested by this wording. The levels considered 'exceeding' and "meeting" will need to be further defined.

- The difference between "substantial credit risk" for Grade B vs "material credit risk" for Grade C is unclear and the trigger breach will ultimately be the deciding factor as to whether a bank is considered Grade B or C.
- Grade A as defined could cover a wide spectrum of agency rating equivalent of AAA to BBB- and Grade B defined to be of 'substantial credit risk' would be close to B+ or worse agency rating equivalent. Introduction of another Grade in between the proposed A and B would provide for more risk differentiation and better alignment with ECRA. The 4 grades would map to 35%, 50%, 100% and 150% as it is recognized that the lower 20% RW under ECRA would not apply given more uncertainty in grade assessment.
- The distinction between Grade C and Default should be further differentiated as both are assigned a 150% RW.

#### Public Disclosure of Credit Assessment

We do not believe that public disclosure of information about a bank's credit risk assessment will facilitate comparability of due diligence analysis performed. Generally, fundamental credit analysis performed by banks would focus on similar information and each bank will have its own risk management structure and process in adjudicating credit risk. Hence, disclosure of this information will not provide for meaningfully comparable information. There will be some variation in due diligence analysis and credit views among different banks but given the SA is by design intended to be a simple approach with embedded conservatism, this variability should be expected. In respect of the Committee's concern on market discipline, reliance should be placed on banks' internal governance and regulatory oversight, to ensure that appropriate due diligence aligning with the SA criteria is applied. The criteria for due diligence analysis and grade slotting could also be further refined to minimize ambiguity.

#### Risk weight floor based on Country Risk Rating for SCRA

If the Committee's concern is that the grading criteria do not incorporate macro risk profiles of exposure not captured in the grade criteria, the floor can be limited to banks operating in higher risk countries. We believe that a floor based sovereign rating is supportable and is currently reflective of our internal methodology for determining a counterparty risk rating.

#### Short Term Interbank Exposures

The risk weights for short term interbank exposures to banks rated A- and better are still unduly punitive. To better align with the A-IRB approach, we believe that the risk weights should be reduced to 10%.

We believe that the Committee should also quantify through the QIS process whether there is a significant impact to setting the short-term interbank exposures maturity to be 3 months or less based on residual maturity vs. 3 months or less based on from origination date.

#### Classification of Securities Firms

The requirement to disclose risk drivers used in ascertaining applicable risk weights should be removed as this does not align with the revised bank risk weights assessment.

**CBA Members' Comments and Requests for Clarification**

**1.1.2 Exposures to corporates (p. 7)**

For banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes

Some A-IRB Banks focused on their internal ratings may not collect external ratings for all externally rated entities. In addition, many commercial entities are not externally rated, putting them at a disadvantage for loan availability, pricing, etc.

Some banks may not have robust processes to collect and utilize external rating on all corporates internationally. This will require a significant investment in infrastructure and result in costs for additional feeds.

For unrated corporates, the same preferential 75% risk weight proposed for banks in jurisdictions that do not permit external ratings should apply, subject to issues with the criteria discussed below.

For banks incorporated in jurisdictions that do not allow the use of external ratings for regulatory purposes

- The definition of 'investment grade' requires more clarity for consistent application. In order to assess if the entity "has adequate capacity to meet their financial commitments in a timely manner, irrespective of economic cycle and business condition", various forecasting assumptions and sensitivity analysis would need to be performed, especially during benign periods, and this would inevitably lead to more variability among banks. This definition also suggests that the assessment is based on a through the cycle assessment that may not be aligned with the A-IRB approach that assumes a one year horizon view. We recommend amended wording along the lines "(entity) has adequate capacity to meet their financial commitments in a timely manner over a one year horizon and there are no foreseeable material changes in the entity or economic/operating environment that may adversely affect its capacity beyond the one year horizon". We also request clarification on whether this would be from a cash flow perspective or balance sheet (leverage) perspective or both?
- In addition, restricting the "investment grade" category to only publicly listed entities is very punitive. § 173 of Annex I sets the following condition [*For corporate entities...must have securities outstanding on a recognized securities exchange*]. This definition is not risk sensitive as being publicly listed is not necessarily commensurate to risk. This definition would potentially have undesired consequences on the lending practices and portfolio composition as the majority of the corporate borrowers are not necessarily publicly listed.
- We recommended that the definition of investment grade, as stated in paragraph 173, also be included in the corporate exposure section versus referencing the operational requirements for credit derivatives section.
- The Banks that operate in countries, which do not permit external rating agencies, would have to develop a new process to identify "investment grade" corporate exposures which will be risk-weighted 75%. This will require making investments on methodology and systems, new training of credit officers, etc.

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- Granularity of risk differentiation is insufficient especially for high quality lower risk Corporate entities, if the SA will be used as an A-IRB capital floor. Under the A-IRB approach, it is not uncommon or unreasonable for entities to have risk weights that are much lower than 75%. Examples include entities that are well collateralized throughout the loan term with low LGDs, shorter term exposures and or entities in certain sectors with demonstrably low PDs. We recommend, for jurisdictions that do not allow external ratings, the establishment of another risk weight category at 50% for justifiably lower risk exposures that can be defined with industry input, and a higher risk weight category at 120% for entities with higher default risk. This would provide more risk granularity and better align with the granularity provided for Bank exposures.
- SME risk weights are not necessarily lower than Corporate risk weights. At minimum, we recommend applying the same approach for Corporate Non-SMEs and SMEs.
- There appears to be no options regarding the 85% risk weight to be used for unrated SME's. Does this mean that the due diligence requirement is not necessary and is redundant in these cases?
- Use of the term "investment grade" can be misleading as this should be reserved for agency rating classifications. The intent here should not be to align non-rated 'investment grade' entities with rated 'investment grade' entities as they are not comparable. We suggest that more granular risk weights should be applied – eg. an approach similar to the SCRA used to classify Banks.

**1.2 Specialised lending exposures to corporates (p. 8)**

Given that most specialized lending facilities are based on the premise that the project will generate sufficient funds to repay the loan, we would suggest that a risk-weight of not higher than 100% would be more appropriate. The higher risk weights for object and commodity finance appear excessive at 120%.

Object Finance

The text appears to capture exposures to many small and medium sized enterprises (SMEs – e.g. a truck owner-operator) and perhaps this may not have been the intention of the Committee. The only indication that this may not have been the intent is the language indicating that specialized lending is '*typically*' an exposure to an SPE created to finance and / or operate physical assets. We suggest revising the definition to "specialized lending is an exposure to an SPE created solely to finance and/or operate physical assets on a non-recourse basis where the source of repayment is limited to the cash flows generated by the assets in the SPE".

Further, a flat risk weight of 120% is punitive for what is essentially a secured loan – even as a corporate exposure, an unsecured SME borrower receives at most a risk weight of 85%.

We would request that the Committee provide for industry review the data and research concluding that object finance has demonstrably higher risk and thus warrants the higher risk weight. A regulation that penalizes sound risk management and good economic policy is

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detrimental both for banks and for the broader economy. We suggest alternatives including the following:

- Differentiate riskiness by introducing haircuts for all collateral, not just financial, to recognize LTV and differences in the liquidity of the asset financed. Thus prudent 'object finance' (low LGD) businesses such as dealer floor plan financing, equipment finance leasing & transportation finance, should carry a low risk weight if the LTV is appropriate to the haircut applied.
- Introduce language to restrict specialized lending rules to exposures to SPEs, to limit the impact on ordinary businesses while still targeting a narrow area of risky lending.

Project Finance

The definition of "operational phase" is too ambiguous and should be enhanced. We suggest defining an exposure in the operational phase only when the completion test is met, i.e. when both the physical and operational tests are satisfied. This proposed definition is consistent with the industry practices and would ensure consistent application. Finally, we believe the 150% risk weight during the pre-completion phase is too punitive as this would carry the same risk weight as a defaulted exposure. Instead, we suggest assigning the same 100% risk weight as for an unrated non-defaulted corporate exposure.

Other

The proposals indicate that "(The) Committee proposes to categorize income-producing real estate exposures and land acquisition, development and construction exposures as real estate exposures." It is unclear from this text whether loans secured by real estate that are nonetheless not managed as real estate exposures today – e.g. Operating Lines of Credit secured by commercial real estate - would be deemed Real estate exposures going forward. Such a reclassification is not the current industry practice and if the Committee's intent is to implement this classification, there may be adverse impacts on banks' internal risk policies and risk management frameworks. Similar to unrated SMEs, there appears to be no options regarding the risk weight to be used for unrated object, project or commodities finance. Does this mean that the due diligence requirement is not necessary and is redundant in these cases?

**1.3 Subordinated debt, equity and other capital instruments (p. 8)**

The proposed changes are a flat increase in RWA by product. The approach does not distinguish between various types of equity and debt instruments traded (e.g. industry), the market they are traded in, and also does not take into account diversification or hedging.

We believe that a 250% risk weight is only appropriate for significant equity exposures, as required under the Basel III framework. We believe insignificant equity exposures and exposures to non-financial institutions should be risk-weighted at 100%. The current standardized approach uses 100% and has not been a source of material risk for investing banks. Having the non-significant equity risk weights calibrated as the same risk weight as the significant equity investment appears too punitive given that non-significant investments pose far less risk to investing banks due to smaller concentration / liquidity risk.

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For subordinated debt and capital instruments other than equities, they often carry external credit ratings. We would request use of these external credit ratings in a similar fashion as senior debt in order to ensure the capital requirements are commensurate with the risk taken.

We would also like to clarify whether preferred shares will be considered debt or equity instruments. Will Supervisors also continue to have the ability to apply discretionary thresholds based on materiality, etc.?

**1.4 Retail portfolio (p. 9)**

The orientation criterion to that of an individual or small business is acceptable. Clarification should be provided as to the definition of a SME.

**1.4.1 Regulatory retail exposures (p. 10)**

Please refer to our comments in the cover letter.

**1.4.2 Other retail exposures (p. 10)**

**1.5 Real estate exposure class (p. 11)**

Underwriting requirements

Can the Committee clarify if finished units in an unfinished condominium building would be eligible for national supervisory discretion around favorable capital treatment?

The following requirement (§ 52) is not aligned to current market practice when requesting real estate appraisals - "To ensure that the value of the property is appraised in a prudently conservative manner, ... (an appraisal) must be adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan." In effect, the Committee is imposing a haircut on real estate collateral values. Moreover, this requirement would seem to eliminate the potential to use alternate valuation techniques which are relatively common in the market today (e.g. the use of automated valuation models, drive-by appraisals..etc). Finally, to satisfy this criterion judgment is required by banks to speculate on future housing prices and this introduces inconsistency of collateral valuation across jurisdictions and competitive disadvantage.

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We believe that the restriction on property valuation (i.e. value of the property will be maintained at the value measured at origination unless national supervisors elect to require banks to revise the property value downward) is extremely punitive. This would prevent us from using adjusted loan to value based on house price indices and, operationally, this could require us to order appraisals at every renewal over the life of the mortgage. We would prefer to see conservatism embedded in the extent to which we use adjusted loan to value in capital management rather than a complete ban on loan to value adjustment for house price appreciation.

#### Proposed taxonomy for real estate exposure class

The introduction of one Real Estate exposure class for wholesale and retail is also a major change in classification and a few key areas require further clarification from the Committee:

- Confirmation that the reclassification of all Real Estate exposures into one class will be applied to the standardized approach only. This classification cannot be applied to the A-IRB approach since retail and corporate Real Estate exposures are treated separately with different A-IRB requirements, modelling approaches and capital treatment. For example, non-retail real estate exposures are grouped under the Corporate and Commercial Asset Classes and the rating scale and risk parameters have been calibrated based on these groupings under the AIRB approach. If the proposed new Real Estate Asset Class is applied under the AIRB approach, this would require reclassification of the exposures and recalibration of parameters. Non-retail and retail real estate exposures under AIRB would also be merged under one Asset Class.
- Guidance, which may be subject to national implementation guidance, on classification and capital treatment of loans that are secured by multiple collateral types including but not limited to commercial or residential real estate.
  - For loans where Real Estate is the primary collateral, i.e. account for the highest % of loan coverage, and there is other collateral, how should this be classified? Does a threshold on coverage need to be defined?
- Similar to the comments for Section 1.2 – if the intent is to classify loans such as Operating Lines of Credit secured by commercial real estate as Real Estate exposures where this is not current industry practice, there may be an adverse impact on banks' internal risk policies and risk management frameworks.

#### Other comments

We believe there is a risk weight mismatch for the loans which do not fully qualify for the paragraph 50 requirements. It introduces the possibility for an Alt-A loan that has a low LTV ratio, hence plenty of collateral, to be risk weighted at 100% [paragraph 49 to 55], while a personal loan without any collateral would be risk weighted at 75% [paragraph 45 to 48].

### **1.5.1 Residential real estate exposures (p. 12)**

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We note that the Basel II SA framework allowed the residential definition to include units owner occupied or rented. Specifically, it stated "Lending fully secured by mortgages on residential property that is or will be occupied by the borrower, or that is rented, will be risk weighted at 35%." [paragraph 72, page 24]. We question why rental units are now excluded as per paragraph 50 [pg. 34 of Annex 1].

The revised definitions imply that all single or multiple residential properties to retail or wholesale would be treated similarly although they may have different default/loss behavior. We urge the Committee to include proposals that would recognize these differing risk profiles. There is precedence for such differentiation – e.g. there is existing US guidance stipulating that "...loans secured by multifamily property...for which 50% or more of the source of repayment comes from third party, nonaffiliated, rental income" are deemed to be Commercial real estate". (<http://www.federalreserve.gov/boarddocs/srletters/2007/SR0701a2.pdf>)

Paragraph 55 proposes a risk weight of the higher of 100% and that of the risk weight of the counterparty. Could the Committee clarify what risk weight of the counterparty refers to i.e. is it the external rating based risk weight? Retail clients would not have a risk weight that can be referenced.

With respect to 'co-lending' situations (i.e., where a Bank provides a mortgage with an 80% LTV and a non-bank partner provides an additional 5% - 10% subordinated mortgage on the same residential property to the borrower), greater clarification is required with respect to the LTV calculations for risk-weighting purposes. In such instances, would the proposed Guidelines permit the regulated Bank to risk-weight its share at 35% (i.e., based on the Bank's 80% LTV exposure), or would the Bank be required to risk-weight its exposure at 45% (i.e., based on the Total LTV of the mortgage on the property, which is greater than 80% and includes the subordinated co-lender's participation interest).

**1.5.2 Commercial real estate exposures (p. 13)**

The concerns raised in Section 1.5.1 Residential Real Estate exposures are also applicable for Commercial exposures.

For corporate real estate exposures the counterparty risk weight should also be considered - the transaction may be structured to provide for additional recourse to the counterparty notwithstanding that the primary repayment reliance is on the cash flows from the property. We suggest applying the lower of the counterparty risk weight and the risk weights on Table 10 (this is for RRE). However, we agree with the proposal that the credit worthiness of the counterparty should not be the sole determinant of risk weights and the use of LTV as the primary risk driver in conjunction with underwriting criteria is a more holistic and effective approach. Nonetheless, there may be adverse impacts on banks' risk policies and risk management frameworks where the LTV bands and underwriting criteria as proposed are not materially aligned to existing internal risk management purposes.



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**1.5.3 Land acquisition, development and construction (ADC) exposures (p. 14)**

While the proposed 150% risk weight is aligned to current US regulations for high volatility commercial real estate (HVCRE), it is nonetheless very punitive for real estate exposures for which the main premise for this higher risk weight is that it relates to property "where the source of repayment at origination of the exposure is either the future uncertain sale of the property or cash flows whose source of repayment is substantially uncertain." We would like to be provided with empirical data or studies to quantify the risk weight of 150%.

This approach would become very detrimental in terms of development opportunities in local economies for specialized players. The proposed SA has the potential to impact construction financing in a significant way, as all construction projects will attract a 150% risk weight.

We also find that the proposed criteria for ADC vs IPRE lending is ambiguous and could lead to inconsistent application among banks. A primary criterion for ADC is that repayment depends on the future uncertain sale of the property. However, the IPRE asset class also includes the mortgages where repayment is based on the sale of the property. The definition of *uncertain* in the ADC criteria must be clarified to prevent inconsistent application of the IPRE and ADC asset classes. We believe that the BCBS should also provide more details on what is included and excluded in the land acquisition, development and construction finance category. Guidance is also requested if this category when applied to retail includes residential homes with 4 or less units under construction. Paragraph 50 [page 34] appears to exclude it based on national discretion.

We provide further explanation of our concerns below along with our proposal for separate treatment of land acquisition exposures, and development and construction exposures based on the risk drivers and risk weights noted below.

Land Acquisition Exposures

- The risk weight treatment appears unfair when compared to Object Finance. With Object Finance transactions, where the repayment of the loan is dependent on the cash flows generated by the specific assets financed, a similar trait that exists with land acquisition, Object Finance attracts a lower risk weight of 120%. However, with land acquisition financing, the asset doesn't depreciate as it does with Object Finance (land values may also appreciate during the finance term), the perfection of security is much easier with land as opposed to Object Finance (title versus PPSA filing), the location of the land in the situation of a default is known, and land is not subject to refurbishment. The latter two items will significantly reduce the costs associated with land acquisition collections as opposed to Object Finance collateral.
- Our proposal includes the use of the LTV ratio as the risk driver for land acquisition exposures with the corresponding risk weights below. The higher the LTV, the more risk the bank is willing to accept, and this is reflected in our proposal.

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- We would also note that land banking transactions typically benefit from a strong source of equity into the loan to reduce LTV to 60% or below.

**Proposed Risk Weight table for Land Acquisition Exposures**

|             | LTV ≤ 60% | 60% < LTV ≤ 80% | LTV > 80% |
|-------------|-----------|-----------------|-----------|
| Risk Weight | 90%       | 115%            | 140%      |

**Development and Construction Exposures**

- The blanket 150% risk weight approach to construction loans suggests all construction transactions have the same level of risk. This certainly isn't the case. A 12 month construction build that will be 100% occupied by a national tenant (e.g. Shoppers Drug Mart) has a significantly lower risk profile than a 24 month construction project for the development of a large retirement home that will also then require a 24-36 month lease-up period that is being built with no pre-leasing in place.
- Our proposal includes the use of the LTV ratio and presales/preleasing as the risk drivers for development and construction exposures with the corresponding risk weights noted below. Once again, the higher the LTV, the more risk the bank is willing to accept, and this is reflected in our proposal.
- Pre-sales/pre-leasing determine market acceptance of the project and assist the bank in determining whether the project is being built on a speculative basis.
- A flat 150% risk weight penalizes the level of capital a bank needs to set aside regardless of the risk profile of the construction project.
- A 150% risk weight also penalizes a bank's risk weight treatment as it assumes the worst case scenario, that being a project failure. With regular bank reviews of a construction projects, which occur with every loan draw and will typically include an update on pre-sale/pre-leasing activity, a risk weight table that is based on LTV and pre-sales/pre-leasing reflects a more accurate level of risk than exists with the construction project. A construction project that continues to see improvements in pre-sales/pre-leasing as the construction build continues, will benefit from improved risk weight treatment as opposed to a project that through deteriorating economic or sales performance will need to allocate more capital (this may also require a review of the value of the project which will also impact the LTV).
- A risk weight matrix table based on an LTV and pre-sale/pre-leasing is proposed. This risk weight table recognizes that the higher the LTV, the higher the risk of capital to the bank, however, market acceptance and shocks to market acceptance are also regularly captured with pre-sale/pre-leasing activity and will reflect an appropriate risk weight treatment throughout the life of the construction project.
- A successful project can be risk weighted 150% at time of underwriting and gradually record an improvement in risk weight as pre-sales/pre-leasing occurs throughout the construction build as opposed to recording a flat risk weight of 150% throughout the construction build. In addition, a project that has suffered a reduction in pre-sales/pre-leasing activity (i.e. from construction delays, changes in economic conditions), may record an increase in its risk weight treatment through the pre-sales/pre-leasing test and also

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through re-evaluation of the value of the property (LTV) as the bank determines the cause of the loss of pre-sales and determines if the value of the property should be reduced.

Proposed Risk Weight Table for Development and Construction Exposures

| Risk Weight Treatment |       |                       |       |
|-----------------------|-------|-----------------------|-------|
| Pre-Sales             | ≤ 50% | 50% < Pre-sales ≤ 75% | > 75% |
| LTV                   |       |                       |       |
| ≤ 65%                 | 125%  | 115%                  | 100%  |
| 65% < LTV ≤ 75%       | 135%  | 125%                  | 100%  |
| > 75%                 | 150%  | 150%                  | 150%  |

Additionally, lower CCF's should be recognized for the conditionality in the typical commitments to ADC borrowers that are subject to conditions precedent such as minimum pre-sales level or stage/percentage of completion. Requiring full capitalization when the borrower has accepted the commitment as currently proposed without further differentiation is overly punitive.

As development and construction exposure will have an undrawn commitment throughout the life of the construction build, it is noted with a 150% risk weight and a potential change to the credit conversion factor for undrawn commitments to 75%, a bank will have to set aside more capital than the exposure they have at risk. For every \$1 of an undrawn commitment, the bank will be setting aside \$1.13 in risk weight equivalent.

**1.6 Risk weight add-on for exposures with currency mismatch (p. 14)**

We do not see how the risk weight add-on could be implemented in a simple way that could be reliable and comparable. In addition, it is not clear if this could be readily implemented especially given this requirement is to apply to various asset classes including corporate, retail, and real estate.

Clarity may be required to define when the regulators want to apply the additional risk weight. For example, would the add-on apply if a basket of currencies are hedged into a currency, which is further hedged into the reporting currency? We would also require further explanation on how we determine the currency of a borrower's main source of income for the case of a multinational bank such as HSBC.

While we expect that this requirement will not be material as many banks rarely have currency mismatch for their corporate borrowers, the

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additional 50% add-on also appears excessive. We would request details on how the 50% add-on was determined. Further, in the case of secured residential real estate where the loan advance is in a different currency than the repayment stream but the property is valued in the same currency, it is punitive to gross up the credit risk RWA given substantial credit mitigation exists with no currency mismatch.

We would suggest consideration of a 25% or lower risk weight add-on.

**1.7 Off-balance sheet exposures (p. 15)**

On p. 39 Paragraph 73, the reference to Annex 3 is incorrect. Is this meant to reference Annex 1?

**1.7.1 Unconditionally cancellable commitments (UCC) (p. 15)**

We appreciate that the Committee is attempting to align SA CCF with A-IRB CCF. However, it should be left to the national supervisor to determine whether for regulatory purposes "unconditionally cancellable commitments" are allowed for wholesale products taking into account the domestic legal case laws.

The Committee proposed to eliminate the special treatment of unconditionally cancellable commitments for the wholesale portfolios. The Committee states that "Many of the commitments assigned to this category may only be cancelled subject to certain contractual conditions (therefore, they are not really *unconditionally* cancellable)." It would be more appropriate to keep the lower CCF for the commitments that are truly unconditionally cancellable with the requirement of stronger due diligence.

**1.7.2 Other off-balance sheet items (p. 15)**

CCFs for the wholesale commitments (including unconditionally cancellable) will be calibrated between 50% and 75% which is a very significant increase over the 0% - 50% range under the current Standardized Approach. We believe the QIS results should drive the calibration of CCF. A pre-determined range of 50% to 75% should only be used if justified by the QIS results.

We also believe that applying a 50-75% CCF across the book to note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) does not appropriately consider the contractual conditions embedded into the commitment that must be respected by the counterparties in order to have access to such line of credits [paragraph 66].

The proposal to replace maturity as a determinant of undrawn commitments CCF with other factors (TBD) may have an adverse impact on

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banks' risk policy and risk management framework where they are not used for internal risk management purposes.

See the comment on commitments with conditions precedent in the ADC section above.

**1.8 Defaulted exposures (p. 16)**

Alignment with the A-IRB definition of defaulted exposures is preferred. Annex 1 § 75 has gone past the equivalent AIRB text in that § 75 lists a set of criteria which, if met, would *explicitly* categorize the exposure as defaulted, rather than a set of criteria that are merely *indicative* of default. This direction has the potential for a large increase in the defaulted loans population – e.g. US residential real estate where strict US regulatory guidance has resulted in many loans classified as Troubled Debt Restructures (TDR), often with no loss to the bank, where many of those loans return to performing status for a sustained period of time and become accruing loans. As written in Section 1.8, all such accruing TDRs would become defaulted loans. We suggest the wording should be changed to match the OSFI CAR Guidelines AIRB text that says [The elements to be taken as indications of unlikelihood to pay *include...*] (Chapter 6 § 279), or specify that once a loan returns to sustained performance and accruing status it is no longer in default.

We also believe that a reduced risk-weight of 100% for exposures that are adequately provisioned for at some acceptable level either at the current SA level of 15% or slightly higher should be maintained and not eliminated. It is a more accurate reflection of the unsecured exposure at risk for capital purposes.

This area should also be revisited as part of implementation of Lifetime Expected Losses under IFRS 9.

**1.9 Exposures to multilateral development banks (MDBs) (p. 17)**

We agree with the general approach.

**1.9.1 Eligible MDBs for a 0% risk weight (p. 17)**

We believe the “entry criterion” for MDBs is acceptable. A formal update of any changes to this listing should be made available by the BCBS in order to provide consistency amongst all jurisdictions and ensure appropriate updates at the jurisdictional level when a MDB rating is below AA-.

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|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>1.9.2 Other MDBs (p. 18)</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| We agree with the general approach.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| <b>1.10 Other assets (p. 18)</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| We are in agreement with the revisions.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| <b>2.1 Revised methodology for repo-style transactions (p. 19)</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| <p>We believe the differences across jurisdictions that do not allow the use of external ratings impedes the comparability of risk-weights and hence, complicates analysis by the readers. Additionally, for banks that have international operations, there will be additional costs to accommodate the different reporting requirements across the different jurisdictions. So we suggest that we continue the work to narrow the potential differences where possible to promote more comparable risk weights.</p> <p>The haircuts proposed are unchanged with respect to the previous consultative document and remain very punitive. Further, not allowing risk mitigation for borrowed non-eligible instruments is very punitive and could affect further the liquidity in the market for these securities.</p> <p>We welcome the changes in the formula to account for correlation as these are more risk sensitive and account for diversification benefits within the securities pool – a development which is better aligned with the recent regulatory changes for derivatives SA-CCR. However, we believe the revised calculation is less transparent. The BCBS should provide the quantitative justification for the netting formula proposed as the allowed netting has been reduced as reflected by 0.4 (vs 1.0 in prior formula) x net exposure component of the formula.</p> <p>Es is defined as the net current value for a given security under a netting set (always a positive value). It would be clearer for implementation purposes to notate as “absolute value” (ie. sign-less) rather than “always positive”.</p> |
| <b>2.2 Reintroduction of external ratings in the CRM framework (p. 20)</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| We are in agreement with this change.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |

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**2.3 Other issues (p. 20)**

[bullet one] The Committee should provide the basis on why it believes that core market participants are reflecting short-term wholesale funding with no capital requirements. Would this issue not be addressed by the LCR/NSFR requirements?

[bullet two] It would be helpful to have clarification on whether special resolution regimes refers to the new bail-in requirements or specific laws of a jurisdiction that may create impediments to enforceability. We do not feel the implementation of special resolution regimes is inconsistent with §161 which provides the requirements for recognizing the effects of bilateral netting, provided that (1) the special resolution regimes do not allow for the enforcement of stay periods exceeding two days, (2) the special resolution regimes do not allow for "cherry-picking" and (3) banks do not lose the ability to terminate transactions for events of default that fall outside resolution such as failure to pay and failure to deliver.

[bullet three] It would be more appropriate if this issue was subject to the determination of national regulatory authorities, taking into account applicable laws and regulation of the jurisdiction (i.e., in reliance on ISDA enforceability opinions for the specific jurisdiction). A consistent approach amongst jurisdictions is not required as banks are aware of the relevant jurisdictional rules related to where the businesses operate. We support the continued partial recognition of credit derivatives that exclude restructuring as an event of default for credit risk mitigation. In particular, we would note that there is no value to including restructuring as a credit event in those situations where the obligation being hedged cannot be restructured outside of bankruptcy without the bank's unilateral consent.

**Exposures to non-central government public sector entities (PSEs) (p. 26)**

An increase in PSE risk weights may result in unintended consequences, such as additional debt being issued under Public Private Partnerships (PPPs). Investments in PPPs should thus be monitored to ensure that they are regulated and reported as public debt.

**Exposures to securities firms and other financial institutions (p. 30)**

We appreciate the Committee clarifying the definition of a "financial institution" as consistency in usage will increase comparability. We welcome the development that securities firms and other financial institutions will receive capital treatment similar to banks when subject to the same regulatory requirements. In the case of brokers owned by banks, it will eliminate the need for such banks to provide parental guarantees to its subsidiaries' counterparties.

It should be noted, however, that many securities firms and other financial institutions are not subject to capital or liquidity requirements and will be treated as corporates. This will require changes to data and systems.

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**Implementation considerations in jurisdictions that allow use of external ratings for regulatory purposes (p. 42)**

We seek further clarification on the definition/determination of domestic vs foreign currency ratings. The proposed approach is very dependent on the country/jurisdiction; we recommend an approach that is not jurisdictionally dependent.

**Credit risk mitigation techniques for exposures risk-weighted under the standardized approach (p. 45)**

The maximum haircut which increases from 25 to 30% for collateral does not consider that the haircut is already a conservative approach as all collateral portfolio for which a financial institution does not have access to the detailed positions are applied the maximum haircut [paragraph 140 to 149]. Intuitively it is possible to assume that some of the positions in these portfolios would have a lower haircut than 30%.

**Collateralized transactions (p. 48)**

The comments for Section 2.1 apply here. In addition, as described in paragraph 133(c), and later referenced by paragraph 145, eligible financial collateral requirements in jurisdictions that allow the use of external ratings for regulatory purposes include debt securities issued by banks that are not rated, subject to certain other requirements. It is not consistent with common practice in the market to not also include certain unrated sovereign bonds as eligible financial collateral. Many collateral arrangements include sovereign debt as eligible collateral. Most issues of debt by a particular sovereign are rated and the sovereign itself will have an issuer rating, but there can often be specific issues that do not get rated. It seems an unintended consequence to exclude a particular sovereign issue when the sovereign itself attracts a strong rating and most of the debt is similarly rated. Moreover, the restriction to banks creates inconsistency with 133(d) where debt issued by "sovereigns or PSEs that are treated as sovereigns by the national supervisor" are included as eligible financial collateral in jurisdictions that do not allow the use of external ratings for regulatory purposes. We therefore suggest expanding the eligibility requirements in jurisdictions that allow the use of external ratings for regulatory purposes to include unrated sovereign and PSE debt where:

- All rated issues of the same seniority by the issuing sovereign or PSE are rated at least BB-;
- The bank holding the security as collateral has no information to suggest that the issue justifies a rating below BB-;
- The supervisor is sufficiently confident that the market liquidity of the security is adequate; and
- In the case of PSEs they are treated as sovereigns by the national supervisor.