中国银行业协会
CHINA BANKING ASSOCIATION

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To：Basel Committee on Banking Supervision

Bank for International Settlements

CH-4002 Basel, Switzerland

Re: BCBS Consultation on Revisions to the Standardised Approach for credit risk

Dear Sir/Madam,

We are writing to you as China Banking Association representing Chinese banks on the subject of ***Revisions to the Standardised Approach for credit risk.*** China Banking Association (CBA) is a nationwide non-profit self-discipline organization of China's banking sector. CBA serves for the common interest of its members through the functions of self-discipline, rights protection, coordination and service so as to safeguard lawful rights and maintain market order of the banking sector, and promote the healthy and sustainable development of the industry. By July 2014, CBA has 373 members and 4 observers.

We sincerely appreciate and support BCBS seeking to substantially improve the standardized approach for credit risk in a number of ways. At the same time, we agree that the proposals are still at an early stage of development and the impact of the proposals should be carefully assessed. Below are our specific comments for your reference, which we hope can be helpful. And we sincerely appreciate the great endeavor you have made in the global regulatory reforms.

Yours faithfully,

杨再平

Yang Zaiping

Executive Vice President

China Banking Association

Comments from CBA

1. Comments on exposures to banks

(i) Regarding risk drivers for bank exposures – capital adequacy

The Committee is considering assigning risk weights to bank exposures according to counterparty's CET1. However, we are concerned with contagion risks that may result from such arrangement. If a bank's capital adequacy ratio is reduced, then all lending counterparties' CAR will be reduced correspondingly, thus resulting in risks being constantly transmitted within the banking system. According to the data, CET1 ratio is not much correlated with the probability of default (PD), and for small-sized banks in particular, high CET1 ratios are associated with high PDs .

We suggest that the Committee consider leverage ratio as the risk driver instead of CET1 risk-based capital ratio. Leverage ratio, in comparison to CET1 ratio, is easier to calculate and more comparable.

As suggested by the CP, the Committee is considering the appropriateness of incorporating country risks as an additional risk driver. In our view, incorporating country risk as an additional risk driver might be problematic. The assessment of country risk is currently based on external ratings, and more complicated factors need to be taken into consideration. In this respect, we suggest that the Committee can include country risk in pillar 2 instead of pillar 1if necessary.

(ii) Regarding risk drivers for bank exposures – asset quality

The Committee proposes to use net NPA ratio as a metric for asset quality in measuring bank exposures. However, we have noticed that the net NPA ratio is not defined consistently across jurisdictions in practice. Moreover, this indicator is not readily available from banks' annual reports.

We suggest that the Committee consider the net NPL ratio as an alternative asset quality measure, or as a proxy for net NPA.

(iii) Regarding risk-weights

According to the CP, bank exposures would receive a 300% risk weight max, much higher than a 100% risk weight at the highest under the current SA. Meanwhile, bank exposures would receive the lowest risk weight of 30%, higher than the lowest risk weight of 20% under the current SA. Therefore, we are concerned about the sudden lift of the risk weight requirements. Such stringent requirement may go against the smooth transition from the current to the new SA and more importantly, it may bring uncertainty for the operation of currency market and monetary policy. To this end, we suggest that the Committee decrease risk weights for bank exposures.

2. Comments on exposures to corporates

(i) Regarding risk drivers for corporate exposures – leverage

The Committee has identified "leverage" as being consistently among the best explanatory accounting metrics in credit risk models. However, for certain corporate exposures, leverage ratio cannot adequately capture the real risks that may embed in the special business models. We have identified these corporate institutions as below:

(1) Non-banking financial institutions operate mainly on liabilities, and thus normally have high leverage. However, in comparison to industrial enterprises, non-banking financial institutions have stronger capital reserves, and their internal risk management is also more sophisticated.

(2) Corporates in construction and shipbuilding industry usually operate based on order management, and thus their liabilities are mainly in the form of payment receivables or impairment losses on assets, resulting in constant high leverage irrespective of low risks.

(3) Trade financing and wholesale financing corporates commonly are featured by low gross profitability, high leverage and high turnover rates. These institutions may have high leverage despite of low risks.

(4) For some corporates that adopt robust business management strategies, their liabilities are mainly in the form of customer margin or impairment losses. Their

risk profile is relatively low but leverage could be high.

(5) High-quality corporate clients which are positioned at the upper end of the supply chain may operate through downstream customers' capital as a potential funding source. Their liabilities are mainly in the form of non-interest-bearing payment receivables etc, and may also have higher leverage.

(ii) Regarding the fairness of capital calculation

In emerging markets, the economic scale of enterprises is commonly smaller than that in advanced economies. Revenue for most of the corporate is less than 50 million Euros. We suggest that the Committee take this into consideration and make adjustments for different levels of development of different countries.

(iii) Regarding Risk weights for senior debt corporate exposures

The CP assigns a 75% risk weight to small businesses within the retail portfolio, whereas SMEs within the corporate portfolio would receive a risk weight ranging from 100% to 130%. Risk weights will abruptly increase, in accordance with increasing business scale, thus exacerbating cliff effects. In this regard, we suggest that the Committee subdivide risk-weight buckets for SMEs migrating from the regulatory retail portfolio to the corporate portfolio. Preferential treatments in the transition period could also be considered.

3. Comments on retail portfolio

In principle, we agree with the definition of regulatory retail portfolio as outlined in the CP. Since the new SA should be applicable to all jurisdictions and for different sizes of banks, we suggest that the Committee introduce national discretions, which can be exercised for non-internationally active banks or small-and-medium sized banks.

4. Comments on claims secured by real estate

(i) Regarding the real estate exposures

We suggest that the Committee make further clarification on: 1) whether loans partially secured by real estate should be identified as real estate exposures (for example, to determine the extent or ratio to which loans are secured by the property so that such loans can be classified as real estate exposures). 2)According to the CP, property securing the mortgage should be fully completed, otherwise risk weight would be determined on the basis of counterparty. However, subject to different real estate markets and policies across jurisdiction, we suggest that the Committee further clarify the requirement of "being fully completed".

(ii) Regarding DSC as a risk indicator

The debt service coverage (DSC) ratio is proposed to be one of risk indicators for mortgage loans on residential properties in the CP. However, we are concerned that the DSC ratio would have limitations for the following reasons:

First, we believe that availability and accuracy of the data is by no means guaranteed. The debt service payments are defined as the aggregate amount of all of the borrower's financial obligations that are known to the bank over a given period. To calculate the DSC ratio precisely, all known financial obligations must be ascertained, documented and taken into account at loan origination, including principal, interest, term as well as contract clauses. Given different credit systems in many countries, the real full information of personal income and financial obligations of the borrower is hard to access. Even the related information is accessed, it would be difficult to obtain updated data once a loan has been funded and the loan term of a mortgage secured by properties is commonly for a long run, causing the initial DSC ratio becoming less meaningful over time.

Second, we think that real credit risks from mortgage loans are difficult to be effectively reflected by the DSC ratio. For example, if a borrower applied for mortgage loans from different banks in a short term, time sequence of signing contracts with banks would have led to different DSC ratios which the same borrower would receive from banks, under the precondition of disposable income being constant. As regard to staging servicing loans, a loan term's influence on credit risks would be exaggerated because of its giant influence on the DSC ratio.

Third, we are concerned that the DSC ratio could introduce cyclicality in capital requirements and would be lack of comparability due to different definitions and scopes of disposable income across jurisdictions. In addition, the 35% level at which the DSC threshold ratio has been uniformly set might not be appropriate for different national circumstances as well as common practices across jurisdictions.

To conclude, we suggest that the Committee provide two options and permit small-and-medium sized banks to be subject to the LTV ratio only.

<u>(iii) Regarding two options for exposures secured by commercial real estate</u>

The CP provides two options for exposures secured by commercial real estate. Option A would not recognize the risk mitigation effect of real estate and treat the exposure as unsecured, assigning the counterparty (retail or corporate) risk weight. Option B would determine risk weight according to the exposure's loan-to-value (LTV) ratio, with the lowest risk weight of 75%, higher than the lowest risk weight of 60% for corporate exposures.

We would favor option B, since option B is better than option A in terms of risk identifications and risk weight allocation. On the other hand, we suggest that risk weight being assigned to commercial real estate be decreased, and the lowest risk weight should not be higher than that of corporate exposures.

5. Comments on exposures to multilateral development banks

The treatment of MDBs should not be in the scope of this revision. MDBs are formed with sovereign memberships and the current capital treatment of MDBs still largely relies on sovereign ratings. Given that the Committee has recently launched revisions to sovereign exposures and there has been no clear consensus yet, it is suggested that the CP exclude the treatment for MDBs from the current scope of review, and the treatment of MDBs should be considered together with the capital treatment of sovereign at a later stage if possible.

6. Comments on proposed revisions to the credit risk mitigation framework

The CP (Paragraph 67, Annex 1) proposes that, "in order for CRM techniques to provide protection, the credit quality of the counterparty must not have a material positive correlation with the employed CRM technique or with the resulting residual risks". Meanwhile, for corporate guarantees, the CP (Paragraph 130, Annex 1) states that the entity which has an established control and economic relationship with the counterparty to the guarantee is eligible. The above mentioned proposals focus on different eligibility requirements, which may be problematic in some cases. Most guarantees with an established control and economic relationship have material positive correlations with counterparty, thus not being able to be identified as qualified credit risk mitigation. Whereas some guarantees (i.e. guarantee companies) do not have a material positive correlation with the counterparty, but since they do not have an established control or economic relationship with counterparty, then they are not able to be identified as qualified guarantee.

As such, we suggest that the CP revise the requirement in paragraph 130, annex1, and confirm that credit protection given by entities can be recognized when they do not have a material positive correlation and have a lower risk weight than the counterparty. Thus, guarantee companies will be incorporated into eligible guarantees.

7. Last but not least, given that the new SA will be applied not only to GSIBs, but also

to a wide range of banks with different levels of sophistication, we think that it is important for the Committee to develop a simplified standardized approach in parallel to the new standardized approach. This task itself would contribute to the Basel III implementation process by reducing the regulatory burden, and is also helpful in enhancing the simplicity and comparability of the overall framework.