Close Brothers

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
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Switzerland
baselcommittee@bis.org

Dear Sir/Madam

**Re: Close Brothers response to the Basel Committee on Banking Supervision's consultation on revisions to the standardised approach to credit risk**

Close Brothers is pleased to respond to the Basel Committee's consultation on Revisions to the Standardised Approach for credit risk published on 22 December 2014.

Close Brothers Group plc is a leading UK merchant banking group, providing lending, deposit taking, wealth management services and securities trading. We are listed on the London Stock Exchange and are a member of the FTSE 250. The Group operates through three divisions: Banking, Securities and Asset Management. Our Banking division provides lending to small businesses and individuals, with an emphasis on specialist finance. We also offer deposit taking services to UK businesses and individuals. We adopt a cautious approach to writing loans which, together with our prudent management of our capital and funding, ensures we have been able to lend in all market conditions.

Our lending model is predominantly secured, short-term, small ticket mainly to individuals and SMEs. SMEs are widely acknowledged to be a key driver and important component of economic activity and growth. Our secured lending model is designed specifically to cater to this crucial market providing important financing that may not otherwise be available to these borrowers. We have been supporting small businesses for over 30 years, and by sticking to our consistent low loan-to-value ('LTV') and our secured lending approach, we have successfully managed our business through many credit cycles, including the banking crisis in 2008.

**Lack of recognition of benefit of secured lending**

As a small UK bank, we apply the standardised credit risk approach that results in high effective weighting across our lending portfolio. Direct comparisons are difficult, but applying our own default experience and based on anecdotal evidence, such as from Pillar 3 disclosures, current standardised weightings are considerably higher than equivalent IRB weightings. Importantly as a secured lender, the existing and proposed standardised credit risk methodologies provide no recognition of the tangible and proven benefits of security. Our excellent loss record with a maximum annual loss rate of less than 3% over 30 years and consistent profitability supports our view that 100% standardised weightings are already sufficiently prudent, particularly for secured lending to small corporates and SMEs.

The corporate methodology proposed is focused on the probability of default, with little recognition of loss given default. We believe that the proposed treatment for residential property lending, where LTV is used, should be extended across other asset classes. It is our strong belief, supported by our extensive experience, that LTV is a key differentiator that should be applied more widely and will result in prudentially sound outcomes.

**Application of leverage condition for lending to corporates**

A key determinant in the proposed treatment of lending to corporates is the requirement to determine each corporate's leverage based on latest financial statements. This raises a number of concerns, particularly in relation to lending to SMEs and smaller corporates.

We are particularly concerned that the smallest SME entities, many of which are by their nature highly leveraged, will be disproportionately impacted. We agree that leverage is an important determinant when lending on an unsecured basis, but is demonstrably less important when lending on a secured basis due to the credit risk mitigation provided by the security. Making no distinction between secured and unsecured lending to such businesses does not in our view properly reflect the risk profile of the lending. Our extensive experience demonstrates that the secured lending model mitigates the risk of lending to smaller businesses. In many cases, secured lending could be the only source of finance available to these borrowers, so the imposition of 300% risk weights against lending to these customers is unduly penal and prohibitive. It is possible that the current proposals could exclude smaller borrowers from lending markets.

We believe that the standardised approach should appropriately reflect the overall risk profile of bank lending, taking account of all viable forms of credit risk mitigation, and not just focusing on likelihood of default as is proposed. Accordingly, we believe that while it may be appropriate to apply a risk weighting over 100% to unsecured lending to highly leveraged businesses, it is not appropriate to do so where that lending is secured with low LTV where the current risk 100% weighting is already sufficient. Our experience, particularly through the banking crisis in 2008, provides strong evidence to support this view.

**Use of financial statements for determining corporate leverage**

Relying on audited financial statements to determine corporate leverage could in many cases result in an incorrect treatment for the following reasons:

1. Many businesses, particularly the smallest ones, do not produce audited financial statements
2. Audited financial statements are by their nature out-of-date, so may not reflect the current situation, and
3. Use of cost based accounting could mean a business's main assets, such as premises, are accounted for below current market value

As a result, it is possible that a business's accounts could present an incomplete picture of its financial health, and so viable businesses could end up being inappropriately deemed highly leveraged or in negative equity, so attracting the default 300% risk weighting. This could lead to higher funding costs for these businesses, or inability to obtain financing at all.

In summary, we believe the proposals should be amended to:

- Distinguish between unsecured and secured lending,
- Reflect the lower risk profile of secured lending with low LTV, and
- Provide some form of recognition of the limitations of using financial statements of smaller businesses

We would be happy to discuss or provide further information on any of the matters set out in this response.

Yours faithfully