March 27, 2015

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Co-Chairs, Task Force on Standardized Approaches
Basel Committee on Banking Supervision
Centralbahnplatz 2, Basel
Switzerland

Dear Sirs

**Comments on:**

- **The proposed revisions to the standardized approach for credit risk;**
- **The design of a capital floors framework.**

DBS Bank is pleased to provide its comments on the Basel Committee on Banking Supervision's (BCBS) proposed revisions to the standardized approach for credit risk and its initial views on the design of a capital floors framework. Our detailed responses to the specific questions posed are attached at the Appendix to this letter. We set out our broad observations below.

*Considerations in the design of the standardized approach for credit risk ("SA(CR)")*

The impact of the revised standardized approaches on banks' regulatory capital requirements will be significant going forward, considering that these will collectively constitute the basis for the planned capital floors. This magnifies the tension that we continue to encounter among the objectives of simplicity, risk sensitivity and comparability as we seek to converge on a viable conceptual framework. As the standardized approaches are meant to be applicable to all banks, the simplicity objective would appear to be the primary consideration; however, in view of the intention to calibrate the capital floors using the output of the standardized approaches, we believe that risk sensitivity is actually more critical. This is particularly important for the SA(CR), as credit risk is the single most important category for most banks.

The effort involved in introducing an entirely new SA(CR) that would meet these requirements would not be trivial, and adequate time will be needed for a thorough initial impact analysis and any consequent re-calibration. The proposed SA(CR) introduces various new risk drivers that could potentially introduce added uncertainties into existing regulatory changes. For example, the reference to CET1 ratios as a risk driver for bank exposures introduces an element of circularity - the introduction of SA floors could lead to lower CET1 ratios for banks in the future, thereby triggering higher risk weights in turn. It is often difficult,



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without the luxury of time, to comprehensively understand the aggregate impact of regulatory change or be properly equipped to manage unintended consequences.

Considerable IT expenditure will be incurred for banks to maintain an entirely new set of risk drivers, as these are not the usual parameters that are currently used in regulatory capital reporting. In addition, the proposed risk drivers do not have harmonized definitions across jurisdictions, so implementing them in a comparable way would be challenging. At the same time, regulatory capital reporting will still have reliance on external ratings which remain integral for securitization exposures, and under the FRTB rules.

The executive summary of the consultation document states 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 underlying risk." The proposed changes, however, indicate otherwise. For example, the minimum risk weights for bank and corporate exposures would increase, respectively, to 30% and 60%. A 300% risk weight has also been introduced for certain categories and which will apply in instances of information unavailability. These risk weights are too punitive and could generate the wrong incentives for banks, particularly in the context of the capital floor.

Taking these considerations into account, we suggest that the focus should be on making incremental, targeted improvements, while retaining areas that are working well. Our recommendation therefore is for the Basel II SA(CR) to be used as a start.

*Leveraging the Basel II SA(CR)*

The Basel II SA(CR) fulfills the simplicity criterion, and seeks to be risk-sensitive by differentiating credit risk through external ratings. While we concur with the BCBS' view that external ratings should never become a substitute for robust credit analysis, we also believe that, for asset classes such as banks and corporates, external credit ratings can complement internal credit analysis. Following the financial crisis, criticisms on the performance of and overreliance on external ratings were centered on specific asset classes, particularly securitization and sovereigns. However, for banks and corporates, the external rating process and methodology do take a holistic view of the applicable credit risk profile. The insights are technically superior to what we could discern from one or two standalone risk drivers. Unilaterally, these drivers are inappropriate representation of risks.

Where external ratings are not available, alternative approaches could be considered, including the use of risk drivers identified in the consultation paper. However, we would suggest that, in developing these alternatives, due consideration should be given to jurisdiction-specific features. For example, as we mentioned in our detailed response, having risk weights be a function of revenue penalizes corporates in emerging economies, which are typically small or mid-sized corporates (SMEs). It is also common to find SMEs with negative equity (and which will thus be penalized given the resultant infinite leverage), but with quasi equity via subordinated shareholders' loans.



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*Design of capital floor*

With respect to the proposed capital floor, we are of the view that simplicity should be the key guiding principle. We are thus, on balance, more supportive of an aggregate RWA-based floor at this juncture. Nonetheless, a period of assessment and observation will be critical before definitive conclusions could be drawn on the conceptual merits of a capital floor, its structure, and calibration.

On the two options that have been put forth to adjust for differences in the treatment of provisioning for credit risk, we see stronger merit in Option 2's approach, where the relevant provisions are translated to a RWA-equivalent using the 12.5 multiplier. This is consistent with the existing rules that would translate a credit, market and operational capital charge to the applicable RWA, and is thus likely to be something that the market is familiar with. Option 1 retains the current differentiation in terms of how provisions impact CET1 and Tier 2 capital, but there is no real clarity on the drivers for distinguishing provisioning adjustments in this manner in the first instance.

*Conclusion*

We trust that our comments, together with the detailed ones in the Appendix, will be useful for the BCBS' further analytical work.

Yours faithfully

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## APPENDIX

**DBS' Feedback on BIS Consultation Document (Standards) – Revisions to the Standardised Approach for Credit Risk**

| S/N | Question | Para no. of Annex 1 | DBS' Feedback |
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| **Section 2: Proposed revisions to the standardised approach for credit risk** | | | |
| 2.1: Exposures to banks | | | |
| 1 | Pg 7, Q1: What are respondents' views on the selection of the capital adequacy ratio? In particular, is the CET1 ratio superior to the Tier 1 ratio or the Leverage ratio? Do respondents agree that it is necessary to require calculations in accordance with Basel III in order to ensure a consistent implementation? | 12 to 14 | Given that there are serious practical methodology and technical issues involved in ensuring that the calculation of the CET1 ratio is consistently implemented amongst banks globally, we are of the opinion that the Leverage Ratio would better ensure consistency and comparability.<br><br>Also, we note that a bank's CET1 ratio would be a function of its own risk weights (and therefore the risk of 'a risk based capital requirement' containing a risk driver that itself is 'predicated on a risk-based measure'). This could be circular and would produce sub-optimal results.<br><br>We agree that it is necessary to require calculations in accordance with Basel III in order to ensure a consistent implementation. |
| 2 | Pg 8, Q2: Do respondents believe the net NPA ratio is an effective measure for distinguishing a bank exposure's credit risk? What alternative asset quality measure, if any, should be considered by the Committee? | 15 | We conceptually agree that the usage of net NPA would be more appropriate than gross NPA. However, it is to be noted that there is one major limitation to the approach, which is that the definition and recognition of NPA may differ across jurisdiction. |
| 3 | Pg 9, Q3: Do respondents have views on the proposed treatment for short-term interbank claims? | 18 | In order to eliminate subjectivity in determining which interbank claims are expected or not expected to be rolled over, we propose that the Committee use an objective criterion, i.e., contractual maturity. |
| 4 | Pg 10, Q4: Do respondents have suggestions on how to address these concerns on the treatment of exposures to banks? In | 12 to 18 | We would urge the Committee to retain the use of external ratings for risk-weighting exposures to banks given the high ratings penetration and that the external rating process takes a holistic |

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| | have views on how to treat exposures to banks not subject to Basel III in a consistent and risk-sensitive manner? | | would be superior to the proposed approach based on two ratios. Notwithstanding various criticisms on the reliance on external credit ratings during and after the Global Financial Crisis, we believe that the rating methodologies used by the rating agencies for banks and corporates are sound and should not be completely discredited, unlike the methodologies for (re-)securitisations.<br><br>On the other hand, we recognise that the proposed look-up table will be useful for risk-weighting exposures to unrated banks.<br><br>This would minimise the need to apply the 300% risk weight in cases where an obligor bank has not published the relevant information within the frequency required by the Pillar 3 disclosure requirements.<br><br>If the Committee ultimately concludes based on the QIS results and other studies that the CET1 and Net NPA ratios are appropriate drivers for risk weighting, we urge that national supervisors be required to publish the risk weights of all banks within their respective jurisdiction to eliminate discrepancies and to ensure complete consistency and comparability across banks<br><br>If this requirement is not imposed, at a minimum, each national supervisor should be required to publish a list of banks in its jurisdiction that have breached any binding minimum prudential standard required by their national supervisor. This would ensure the consistent application of the 300% risk weight for such cases. |
| 2.2: Exposures to corporates | | | |
| 5 | Pg 12, Q5: Do respondents have views on the selection of risk drivers and their | 22 | Similar to our response on Q4, we are of the view that external ratings should continue to be used for the reasons |

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| | definition, in particular as regards leverage and the incorporation of off-balance sheet exposures within the ratio? Would other risk drivers better reflect the credit risk of corporate exposures? | | mentioned.<br><br>Having said that, we note that the proposed risk weights are a function of leverage and revenue and that the risk weights are much higher for the corporates with low revenues (less than EUR 50m). This would penalise corporates in emerging economies which are typically small or mid corporates at best by the standards of developed economies. In addition, in the Asian context, it is not uncommon to find SMEs with negative equity, but with quasi-equity via subordinated shareholders' loans.<br><br>If the Committee assesses and decides that leverage and revenue are appropriate risk drivers, we suggest that the Committee recalibrate the thresholds in order to take into account the economic scale of companies in emerging economies.<br><br>We note that under the current SA (CR), the risk weight for an unrated corporate is 100% (where risk weights for corporate exposures ranges from 20% to 150%). Under the revised SA (CR), the risk weight ranges from 60% to 300% (i.e. 3 times more for the "best" corporates and 2 times more for the "worst" corporates). We find these risk weights too punitive and suggest that the risk weights be recalibrated to bring it more in line with the current SA (CR).<br><br>We also note that the application of higher risk weights for smaller corporates is inconsistent with the adjustment in the IRB risk weight function for smaller corporates (i.e. the application of firm-size adjustment) per the current regulatory rules.<br><br>Lastly, the use of Euro-denominated tiers could introduce unwarranted foreign exchange-induced volatility in the capital requirements of banks that do not adopt |

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| | | | the Euro as their functional currency. There should be adjustment mechanisms made available to manage this impact. |
| 6 | Pg 12, Q6: Do respondents have views on the appropriateness of the proposed treatment, especially with regard to SMEs? And about the more lenient treatment for start-up companies? | 26 | We note that the treatment for start-up companies are the application of a more lenient risk weight of 110% (instead of 300% that would be applied for corporates that do not have the required financial ratios available) only for the first year. We support the spirit of the proposal but note that the jump-off to 300% in the second and subsequent years may lead to borrowers and lenders to game the rules in order to stay at the 110% risk weight. However, in the context of the Singapore financing environment, these start-ups would typically be subsumed under a government supported lending programme or scheme. It is also not uncommon for start-ups to seek financing through private investors (venture capitalist, hedge funds, angel investors and etc.). As such, it would be helpful if the Committee could clarify its specific policy intention on this rule. |
| 7 | Pg 12, Q7: Do respondents think that the risk sensitivity of the proposal can be further increased without introducing excessive complexity? | 20 to 26 | See our responses to Q4 and Q5. |
| 8 | Pg 13, Q8: Do respondents agree that introducing the specialised lending category enhances the risk sensitivity of the standardised approach and its alignment with IRB? | 27 to 29 | We are generally supportive of the introduction of the specialised lending category and have the following comments:<br>a) We think that flooring the risk weights at 120% for PF, OF, CF and IPRE and 150% for land acquisition, development and construction exposures is not meaningful as it over penalises SL exposures. We note that based on current regulatory rules (supervisory slotting), the assignment of risk weight for SL exposures is from 50%;<br>b) The quality of the underlying |

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| | | | asset being financed which is a fundamental consideration in SL is not directly considered in the assignment of the risk weight.<br><br>As such, we propose that the Committee keep to the supervisory slotting criteria approach as per the current capital rules. |
| 2.3: Subordinated debt, equity and other capital instruments | | | |
| 9 | N.a. | 30 to 32 | We note that paragraph 32 proposes that subordinated debt and capital instruments other than equities will receive a risk weight of 250%.<br><br>We believe this to be overly punitive and lacking in risk-sensitivity.<br><br>If our proposal above to have external ratings continued to be used for bank exposures is accepted, then we propose that the risk weights for subordinated debt and capital instruments other than equities likewise be based on external ratings.<br><br>If not, we would propose an approach similar to that being proposed for senior bank exposures in the consultation paper. |
| 2.4: Retail portfolio | | | |
| 10 | Pg 14, Q9: Can respondents suggest, and provide evidence on, how to increase the risk sensitivity of the regulatory retail exposures treatment, either by differentiating certain product subcategories for which a specific risk weight may be appropriate; or by suggesting simple risk drivers that could be used to assess the risk of all retail exposures? | 33 to 35 | While the Committee has laudably sought to enhance the criteria for the application of the 75% risk weight, it should also be acknowledged that the existing 75% risk weight is not sufficiently sensitive to the wide variety of exposures contained within the 'Regulatory Retail' exposure asset class.<br><br>The Committee should consider:<br>a) Recommending different risk weights for secured and unsecured retail exposures; and<br>b) Within each category (i.e. secured and unsecured) the risk weights should vary depending on the Debt Service Coverage |

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| | | | Ratio or repayment capability of the borrower.<br>Alternatively, instead of a) and b) above – simpler approaches such as using LTV and DSCR together to determine risk weights could also be worth considering. |
| 2.5: Claims secured by real estate | | | |
| 11 | Pg 16, Q10: Do respondents agree that LTV and/or DSC ratios (as defined in Annex 1 paragraphs 40 and 41) have sufficient predictive power of loan default and/or loss incurred for exposures secured on residential real estate? | 40 to 41 | LTV and DSC are some of the predictive variables for potential loan losses on a performing retail mortgage portfolio. In addition, the Committee should also consider applying a flat risk weight for those mortgage loans that already have 'days past due' attached to them (but not defaulted). In this case, regardless of the LTV and DSC, arguments can be made to assign a higher risk weight for 'overdue' accounts.<br><br>Also, see response to Q13 below. |
| 12 | Pg 16, Q11: Do respondents have views about the measurement of the LTV and DSC ratios? (In particular, as regards to keeping the value of the property constant as measured at origination in the calculation of the LTV ratio; and not updating the DSC ratio over time.) | 40 to 41 | The newly proposed DSC driver will be challenging to implement. In general, the income information available is the income information provided by customers during the application of the loan. As it is not updated during the life span of the loan, the information on the income available can be obsolete. It will be costly and onerous for banks to request customers to update their income data regularly. Thus we propose to use DSC driver measure at loan inception only and not required to be updated over time.<br><br>Point 40 in Annex 1 mentions that for regulatory capital purposes, when calculating the LTV ratio, the value of the property will be kept constant at the value measured at origination, unless an extraordinary, idiosyncratic event occurs resulting in a permanent reduction of the property value.<br><br>The definition of such an event should be specified. |
| 13 | Pg 16, Q12: Do | 40 to 41 | DSC ranges rather than a fixed threshold |

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| | respondents have views on whether the use of a fixed threshold for the DSC ratio is an appropriate way for differentiating risks and ensuring comparability across jurisdictions? If not, what reasonably simple alternatives or modifications would respondents propose while maintaining consistent outcomes? | | would help to mitigate cliff effects and would hence be preferred. |
| 14 | Pg 17, Q13: Do respondents propose any alternative/additional risk drivers for the Committee's consideration in order to improve the risk sensitivity in this approach without unduly increasing complexity? | 36 to 42 | For residential mortgage exposures, the personal liability of a borrower should be taken into consideration. Ceteris paribus, the risk weight in a jurisdiction where a borrower cannot "walk away" from a residential mortgage loan by handing over the keys of the property to the lender should be lower than the risk weight in a jurisdiction where such personal liability does not apply. |
| 15 | Pg 17, Q14: Which of the two options above is viewed as the most suitable for determining the risk-weight treatment for exposures secured on commercial real estate? | 43 to 48 | The Bank opines that the second option proposed (i.e. assigning a risk weight to the exposure from a table of risk weights ranging between 75% and 120% based on the LTV ratio) is more suitable as it is more aligned with the underlying risks for commercial real estate exposures. |
| 16 | Pg 17, Q15: What other options might prudently increase the risk sensitivity of the commercial real estate treatment without unduly increasing complexity? | 43 to 48 | The predictive power of LTV alone might not be sufficient (as there are many other risk drivers that could be relevant to this asset class) to assess the riskiness of borrowers related to this asset class.<br><br>It is worth noting that in contrast to corporate lending (where the risk drivers and importance attached to them are broadly similar for many institutions), for the CRE asset class the type of risk factors and importance attached to them might vary across different institutions. In light of this, a variety of risk drivers from the list below could be considered:<br>a) Cash flow-related risk factors: Strength of cash flow, creditworthiness of tenants and |

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| | | | building quality (i.e. the collateral).<br>b) Refinancing risk related factors: This can be assessed by using the indicators such as: 'loan type' and 'reliance on refinance' at the time of repayment. These might cater for the risk or situations where the current deal might expire and the borrower is mainly relying on refinancing the property to repay some or all of the outstanding balance.<br>c) Interest rate risk related factors: for example, deals that are fully hedged might be (fully or partially) sheltered from the direct impact of interest rate changes.<br><br>On a broader point, we urge the Committee to consider allowing local Authorities the flexibility to set the risk weights for their respective national jurisdictions as credit underwriting standards for this asset class would differ from one jurisdiction to another. We also recommend that the Committee considers in earnest other cash-flow related ratios such as EBITDA in its assessment of appropriate risk drivers. |
| 2.6: Risk weight add-on for exposures with currency mismatch | | | |
| 17 | Pg 18, Q16: Do respondents agree that a risk weight add-on should be applied to only retail exposures and exposures secured by residential real estate? What are other options for addressing this risk in a simple manner? | n.a | It is reasonable that retail exposures (and mainly claims secured by residential mortgages) with currency mismatches should attract a risk weight add-on as these exposures would typically be unhedged by the borrowers.<br><br>However, a standard add-on on all such currency mismatches might not be appropriate. Rather, the historical volatility of currency pair should be taken as a base to inform the range of possible add-ons. The Committee should either consider providing currency pair specific add-ons (for the major currency pairs) and/ or leave it to the national supervisors' discretion to assess the |

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| | | | volatility estimated by the firms which in turn would determine the add-on assigned to the currency mismatch risk.<br><br>The Committee should consider providing a standard mapping table wherein the increase in (historical) currency volatility should be linked to the increase in add-ons.<br><br>Drawing from the experiences of the Asian Financial crisis of 1997 where Asian corporates borrowed heavily in USD on the back of favourable rates supported by an optimistic global environment, domestic and external demand, we would also like to propose that risk-weights add-on should also be applied to corporate exposures.<br>It is also to be noted that for retail exposures, the banks would typically have physical collateral to secure the financing, which may not be the case for corporates. |
| 2.7: Off-balance sheet exposures | | | |
| 18 | Pg 19, Q17: Do respondents consider the categories for which a CCF is applied under the standardised approach to be adequately defined? | 54 | Some types of risk are better addressed through robust procedures, systems and internal controls than additional capital requirements. The use of the 10% CCF for unconditionally cancellable commitments may not be meaningful. If the intention is to mitigate against deterioration in credit worthiness of borrowers, this could be addressed by a stringent and frequent credit review process.<br><br>Having said that, we are agreeable to the proposal so long as the definition is aligned with the one used in the Leverage Ratio calculation. The Committee is also urged to consider how this could be further extended to the FIRB approach for consistency. |
| 19 | Pg 19, Q18: Do respondents agree that instruments allocated to each of the CCF categories | 54 | Agreed. |

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| | share a similar probability of being drawn and that the probabilities implied by the CCFs are accurate? Please provide empirical support for your response. | | |
| 02.8: Past-due loans | | | |
| 20 | Pg 19, Q19: What are respondents' views on the alternative treatments currently envisaged for past-due loans? | n.a. | National supervisors should ensure robust provisioning practices. Capital requirements should not be used to address shortcomings in provisioning practices. As such we do not support risk-weighting past-due loans more heavily than performing loans.<br><br>We think that the past-due loans treatment in the current SA (CR) is appropriate to address the risks in past-due loans. |
| 2.9: Exposures to multilateral development banks | | | |
| 21 | Pg 19, Q20: Do respondents agree with the proposed treatment for MDBs? | 10 to 11 | The proposal appears appropriately risk-sensitive. |
| 2.10: Other assets | | | |
| 22 | Pg 20, Q21: What exposures would be classified under "Other assets"? Is a 100% risk weight appropriate? (Please provide evidence where possible) | 60 | Examples include account receivables, fixed assets and etc.; The 100% risk weight appears to be appropriate. |
| **Section 3: Proposed revision to the credit risk mitigation framework for exposures risk-weighted under the standardised approach** | | | |
| 23 | Pg 22, Q22: What are respondents' views on the above alternative ways to define eligible financial collateral? | 92 | We opine that the universe of collaterals should be expanded to include other types of collaterals, e.g., other financial collateral not currently recognised as eligible and physical collateral to narrow the divergence between the Standardised and the IRB Approaches. In particular, the Committee should consider including CDs and physical collateral (prevalent in the Asian economies) as eligible collateral. |
| 24 | Pg 24, Q23: i) What are respondents' views on the recalibrated supervisory | 108 | i. No comments<br>ii. Eliminating references to ratings would hinder the comparability of |

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| | haircuts shown in Table 4? ii) What are respondents' views on how to eliminate references to ratings from the supervisory haircuts table? What could be the implications of eliminating references to external ratings? | | banks' reported ratios. Any national supervisor using Table 5 should also require banks to disclose CAR using Table 4 for international comparability. |
| 25 | Pg 25, What are respondents' views on the proposed corporate guarantor eligibility criteria? | 130 | The proposed corporate guarantor eligibility criteria are appropriate. |
| **Others** | | | |
| 26 | General | n.a. | The Committee should clarify the envisaged practical usage of the revised standards in respect of banks that have permission to use IRB. In particular, is this intended to be a reporting regime for internationally active banks, to supplement the other tools such as Stress Test and Leverage Ratio or solely as a benchmark against other banks? It would be helpful if the Committee could clarify how all these proposed approach in order to drive simplicity and comparability would be used in conjunction with the proposed capital floor. In order to further promote the Committee's agenda, would the Committee be requiring all banks to disclose its capital floors on a standardised approach regardless of whether it is an IRB bank or otherwise? |
| 27 | General | n.a. | Arising from the usage of risk drivers such as CET1 and in particular net NPA, an entity that is funded primarily by wholesale funding (such as investment banks that are not subject to supervision) and does not have any significant loan portfolio may potentially benefit from the lower risk weights under Standardised Approach as compared to a commercial bank that is heavily deposit-funded. |

**DBS' Feedback on BIS Consultation Document (Standards) – Capital floors: the design of a framework based on standardised approaches**

| S/N | Question | DBS' Feedback |
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| 1 | Pg 6, Q1: Assuming the respective floors were calibrated to achieve the same level of required capital, what are your views on the relative merits of a risk category-based floors and an aggregate RWA-based floor? What are your views on a floor based on exposure class? | We note the intention of the proposal as stated in the Executive Summary of the consultation paper. In particular, point 3 which stated the objective of the capital floor. They are to: ensure that the level of capital across the banking system does not fall below a certain level; mitigate model risk and measurement error stemming from internally modelled approaches; address incentive-compatibility issues; and enhance the comparability of capital outcomes across banks. In order to balance risk sensitivity, comparability and simplicity, we feel that given that the floors are intended to be a backstop, simplicity should be prioritised. Therefore, an aggregate RWA based floor would be preferable and probably more readily welcomed by users of bank disclosures.<br><br>After a suitable observation period, risk category-based floors can be considered as well. |
| 2 | Pg 9, Q2: What are your views on the relative merits of the two options for adjusting for differences in the treatment of provisioning for credit risk? | Option 2 is in line with the current gross up factor of 12.5 for computing capital requirements in RWA. |
| 3 | Pg 9, Q3: Do you have any other comments regarding the design of the capital floor? | As mentioned above, the capital floor should prioritise simplicity over risk sensitivity. |