
Deutscher Industrie- und Handelskammertag

DIHK Comments on the second Consultation Document “Revisions to the Standardised Approach for credit risk”

The Association of German Chambers of Commerce and Industry (Deutscher Industrie- und Handelskammertag e.V. - DIHK) is the umbrella organization of the 79 German Chambers of Commerce and Industry and represents the collective interest of commercial and industrial businesses in Germany. Our legitimation rests on more than 3.6 million member companies from all sectors, regions and size classes that belong to the Chambers of Commerce and Industry.

General Remarks

We welcome the opportunity to comment on the proposed revisions to the Standardised Approach, since any change in regulatory capital requirements can have important consequences for companies' access to finance. Given that a majority of small and medium enterprises (SMEs) in Germany are serviced by banks using the Standardised Approach, we are especially interested in the cumulative effects of the proposed changes on SMEs.

We support that the Committee has considered possible alternatives to the two-risk driver approach. Withdrawing the proposal to base the risk weight of corporate exposures according to a matrix based on a company's leverage and revenue is strongly supported by us. A step in the right direction is also that for unrated exposures to corporate SMEs defined as corporate exposures where the reported sales for the consolidated group of which the firm is a part is less than €50 million, an 85% risk weight will be applied. We are in favor of such a reduction in the new risk weights and suggest assessing whether a further reduction of the risk weights to corporates can be taken into consideration, f.ex. to an 75% risk weight.

We also support the reintroduction of external ratings to exposures to banks and corporates because they can still often be a useful and more precise measure of risk than broad-scale generalizations based on a few variables. With respect to subordinated debt, equity and other capital instruments, most of the risk weights have been reduced. However, it should be further investigated whether they can be lowered furthermore.

Retail Exposures

According to the second consultation document, national supervisors would retain the possibility to define alternative national criteria to the default quantitative granularity criterion. We believe that this flexibility is essential and therefore strongly support this decision. The role of small regional banks (as well as the applicability of the Basel framework to these banks) varies strongly between jurisdictions, and a simple quantitative granularity criterion would strongly restrict use of the retail category e.g. for many regional German banks deeply involved in SME lending. Moreover, depending on the national banking system, an individual bank's portfolio granularity may also not be the best criterion from a supervisory perspective. In Germany, e.g., the institutional protection schemes that cover the large majority of regional banks actually lead to a risk-sharing in the case of an emergency and thus justify a more integrative view of the joint portfolio held by the schemes' participants. For this reason, we would even recommend to change the formulation so that an alternative national granularity criterion is considered a full-fledged alternative to the basic granularity threshold rather than an exceptional case.

Moreover, in order to keep loan application processes manageable, the retail segment should be allowed to include a certain percentage of loans to clients classified as corporates, as long as they were decided in the regular retail process and respect the maximum loan amount of one million euro per client. Loans below this volume often do not justify the separate and much more burdensome treatment of larger corporate loans.

We are still skeptical about the possibility to differentiate by products inside the retail segment, since an internationally comparable product definition would risk to be both extremely complex and to require frequent revisions.

Treatment of Corporates

A step in the right direction is that for unrated exposures to corporate SMEs defined as corporate exposures where the reported sales for the consolidated group of which the firm is a part is less than €50 million, an 85% risk weight will be applied. We support such a reduction in the new risk weights and suggest assessing whether a further reduction of the risk weights to corporates can be taken into consideration, f.ex. to an 75% risk weight. We also support the reintroduction of external ratings to exposures to banks and corporates because they can still often be a useful and more precise measure of risk than broad-scale generalizations based on a few variables.

Credit Conversion Factors

The consultation document now foresees an increased general credit conversion factor (CCF) of 10% - 20% for unused credit lines which can be cancelled at any time by the bank, as opposed to the current 0%, with the exception that it may just be applied to retail. For all other commitments that are unconditional cancellable, the Committee proposes to apply a CCF between 50% and 75%. Such an increase of capital requirements would create a disincentive for banks to provide credit lines and hence reduce the flexibility needed by many companies, with substantial adverse consequences for company financial planning. We therefore strongly suggest keeping the 0% credit conversion factor for credit lines cancellable at any time. Only if a raise of the CCF cannot be avoided, a maximum rate of 10% to SME und corporates exposures should be considered.

Treatment of Banks

The use of external ratings is a helpful approach in order to assure an international comparability of capital requirements. With respect to the External Credit Risk Assessment Approach (ECRA), the external rating is followed by a due diligence process aiming at ensuring that the external rating appropriately and conservatively reflects the credit risk of the exposure. If the due diligence assessment reflects higher risk characteristics than that implied by the external rating of the exposure, the bank would apply a higher risk weight for the exposure. In our point of view, however, it is unclear that the diligence analysis should never result in the application of a lower risk weight than that determined by the external rating. The whole due diligence process would lose credibility if adjustments in both ways are not possible. Furthermore we suggest that due diligence should not be carried out on the level of an individual borrower; it should rather be able to refer to certain homogenous groups of borrowers or certain asset classes in order to reduce additional expenses.

Moreover, defining the notion of 'bank' directly inside the Basel rules creates the risk of a definition that is too narrow to accompany certain national specificities. For the German case, we would in particular recommend a clarification that financial leasing companies continue to be classified as banks. These companies are an important vehicle to finance investments in the German economy, and any increase in their refinancing costs would have negative effects on the financing of investments.

Treatment of Real Estate and Specialized Lending

The current proposal of the Committee differentiates between residential real estate exposures and commercial real estate exposures. It seems unclear why the consultative document rejects the

established practice of splitting an exposure into a secured part (e.g. up to a specified percentage of the LTV) and an unsecured part. We would support maintaining this possibility. In addition to that the proposed risk weights for real estate exposures, especially for the commercial ones, are calculated too high. Besides that landing acquisition, development and construction (ADC) lending is still risk-weighted at 150% which is also considered to be too high. We therefore suggest to review the risk weights for real estate exposures and also take country specific characteristics into account.

Finally, the risk weights of 120% and 150% for the specialised lending categories seem still too high and undifferentiated. The risk weights should reflect both the credit-worthiness of the debtor and the actual degree of risk of the respective project.

Concluding Remarks

The second consultative document already contains important improvements in comparison to the first draft. However, at some points, the Committee argues with higher capital requirements which could put a strain on a reliable lending of banks to SME. We suggest to further assess where lower risk-weights can be applied f.ex. in the treatment of exposures to SME, Real Estate, equity or with respect to the credit conversion factor for unconditional cancellable exposures. This will help to successfully combine the requirements of prudential supervision and the economy's need for a working financial ecosystem.

For further inquiries, please contact:

Dr. Susanne Lechner, lechner.susanne@dihk.de