

11 March 2016

Subject: EBF response to the 2nd BCBS consultation on the revision of the CRSA

Introduction

The European Banking Federation (EBF) welcomes the second consultative paper on the revision of the Standardised Approach for Credit Risk as it improves certain aspects of the first paper following a quick but thorough analysis throughout 2015. The banking industry and, in particular, the European banks have engaged in the discussion from an early stage and do appreciate the opportunities given to provide with arguments and data that will help the Committee in making well-informed decisions on the many aspects involved.

Key points

We would like to outline in this summary, very succinctly, key points that are further developed in the response:

- The re-introduction of external credit ratings is welcomed as it brings risk sensitivity, it enhances comparability and it does not add complexity.
- The due diligence requirement should be reconsidered as it is quite burdensome.
- There is a wide range of corporate exposures without available external ratings that should be treated under the SCRA investment grade option if conditions are met.
- The SME risk weight should be fixed at 75%.
- Purchased receivables would deserve a separate treatment according to their distinct risk profile and following the IRB classification.
- Specialised lending needs more risk sensitivity and to account for the value of the guarantees.
- The loan size criterion for SME definition should be updated.
- The overall risk weights for residential real estate should be reviewed to reflect *appropriate risk weights in jurisdictions where structural factors result in sustainably low credit losses associated with the exposures to the real estate market*.
- Residential loan splitting by Loan-To-Value (LTV) would add risk sensitivity.
- The value of the property should be updated regularly.
- The proposal for Land Acquisition, Development and Construction (ADC) exposures is overly conservative as it assigns risk weights of defaulted exposures. It needs to be reviewed.
- The fundamentals of the currency mismatch proposal have to be reconsidered from a pragmatic viewpoint with real examples, both for corporate and retail borrowers, such as the ones illustrated in this paper.

- The risk weights for defaulted exposures should be reassessed together with the review of the internal rating based (IRB) models in conjunction with this SA review for the sake of consistency.
- A fundamental review of the concept of commitment should be conducted because a significant part of the cases identified within the scope of unconditional cancellable commitments (UCC) are not actually commitments. In this regard, the accounting framework should serve as a point of reference.
- Credit Risk Mitigation (CRM) techniques are applied in the IRB approach. They should be applicable in the Standardised Approach likewise.
- The treatment of shares of UCITS/mutual funds under the Comprehensive Approach should be made more risk-sensitive.
- Covered bonds issued by a credit institution in jurisdictions with specific covered bonds legislation that fulfils certain strictly defined criteria, may continue to have a preferential risk weight treatment.
- Although not part of this consultation, we suggest that BCBS reconsiders its proposal to introduce a capital floor based on SA, since the leverage ratio effectively achieves the objective of providing a capital floor.

Sovereign exposures

1. The EBF agrees that sovereign risk deserves a separate discussion once the CRSA is finalised. Potential analyses of sovereign risk should be conducted at global level.

Exposures to Multilateral Development Banks (MDB)

2. We strongly support the Basel Committee's proposal to differentiate the treatment of banks and MDBs and to keep the use of MDBs' specific external ratings for risk-weighting purposes, given the nature and characteristics of these institutions.

Exposures to banks

3. The use of external ratings adds risk sensitivity at least to the segment of exposures that count with an eligible external rating. However the requirement that credit institutions have to perform a *due diligence* test to ensure that the external ratings appropriately reflect the creditworthiness of the bank counterparties is a source of concern. This additional requirement contests the value of external ratings and a case-by-case due diligence is too burdensome. We think that it is against the simplicity objective of the standardised approach to assess the financial performance of each counterparty by a due diligence test, especially for smaller banks.
4. Another point that we would like to bring up is the minimum risk weight of 150% if any of the published and binding minimum regulatory requirements determined by its national supervisor is breached (paragraph 27). We appreciate footnote 35 making clear, that liquidity requirements in this context are not considered "binding". Similarly, it should be clarified that the countercyclical buffer is not considered binding.



Otherwise, there would be a risk of pro-cyclicality. Such rule may trigger chain reactions: for instance, in case of a breach of buffer requirements the resulting 150% risk weight could amplify the crisis and spark a negative spiral with a clear risk of pro-cyclicality that would bring no benefit in risk appreciation. The chain effects on funding costs should be properly considered in the final calibration.

5. As far as the Standardised Credit Risk Assessment Approach is concerned, we consider that an enhanced granularity should be foreseen in the proposed number of grades and that lower risk weights should be provided, consistently with the 20% bucket envisaged in the *External Credit Risk Assessment Approach* (ECRA) approach. When in this case risk weight buckets apply, there should be a fourth bucket with a risk weight of 20%. In this regard, we would also appreciate clarifications on the rationale of the suggested levels of calibration.
6. The preferential treatment for short term interbank (less than 3 month) exposures should be kept in order to prevent a negative impact on market liquidity in interbank markets. The EBF proposes that:
 - a) We note that the definition of “short-term” as 3 months is too short and it is not aligned with the time horizon considered by the NSFR, which extends to one year. The definition of short term should be extended to one year in order to avoid contradictory incentives between the two regulatory approaches.
 - b) The minimum rating requirement should not apply for exposures with less than 1 month to maturity. Instead, for these exposures, both under ECRA and SCRA, a 20% RW should apply irrespective of the rating of the counterparty and the related sovereign rating;
 - c) The maturity should be computed as residual maturity instead of original; this option does not add much complexity and it makes the assessment more accurate.
7. The Committee should also review the risk weight assigned to interbank exposures with a maturity longer than 3 months:
 - The current approach is overly conservative considering the low default experience of banks which are, after the crisis, much stronger in terms of capitalisation. As highlighted by the recent Basel III monitoring exercise report¹, larger International banks have already made major progress in recapitalization and the capital shortfall has been significantly reduced during recent years;
 - As the proposal currently stands the same bank with the same rating would be assigned a risk weight for these exposures that is more than double the one for short-term interbank exposures. In our opinion there is no fundamental reason for such a gap and it should be narrowed by pulling down the risk weight proposed for longer-than-three-month interbank exposures.
8. The proposals would result in higher risk weights for the exposures to unrated banks in countries with a high sovereign rating as the option to determine the risk weight of unrated banks on the basis of the sovereign risk would be abolished. It would be

¹ <http://www.eba.europa.eu/documents/10180/950548/CRD+IV++CRR++Basel+III+monitoring+exercise+report.pdf/f414a01e-4f17-4061-9b88-4e7fb89cc355>



important to maintain this option as in some markets the role of relatively small nationally operating banks is significant and the cost of obtaining external ratings would be disproportionate. The risk weighting of exposures to such banks in countries with high sovereign rating would, therefore, be unduly penalized as there is no evidence of the need to treat those banks more stringently than in the current framework.

9. Given that the risk profile of covered bonds is quite different from the risk profile of the issuing bank, separate risk weights should be assigned to covered bonds, reflecting the historically low level of losses in the covered bond market. Firstly, it is to be acknowledged that covered bonds are governed by specific legislation that fulfils a number of strictly defined criteria. Secondly, covered bonds are particularly important for banks as they are eligible for liquidity reserves in respects of prudential liquidity requirements (the LCR). It is important that the cost of carrying large liquidity reserves are not unduly high, which they likely would become if covered bonds exposures are treated as other bank exposures. Thirdly, while the covered bonds play a very significant role in the European financial system, similar markets are also developing outside Europe, thus calling for a global stance. In our view it is very important that covered bonds issued by a credit institution in jurisdictions with specific covered bonds legislation that fulfils certain strictly defined criteria, may continue to have a preferential risk weight treatment.
10. Moreover, under the current set-up the floor would apply only in case the country is sub-Investment Grade. In practice, it would flatten the risk weight to 100% and make the grading unnecessary, apart from the identification of stressed counterparts. From this perspective, in case a country-specific risk floor is considered it could make sense to have the grading under Standardised Credit Risk Assessment Approach (SCRA) be limited to Investment Grade countries (this would create a cliff effect that in any case is implicit under the current proposal).

Exposures to securities firms and other financial institutions

11. The definition for securities firm and other financial institutions would leave a number of institutions out of the scope of this category of exposures, therefore being subject to the treatment of corporate exposures instead of bank exposures. In particular, it is not clear if financial institutions which are subject to the main but not to all the prudential standards and a level of supervision equivalent to those applied to banks fall within this category. For instance, in Europe this could be the case of the investment firms which are subject to risk-based regulatory capital and other prudential requirements but not to liquidity requirements. The exclusion of the investment firms would clearly contradict an accurate risk representation and an increased risk sensitivity. We also suggest specific risk weights should be introduced for other regulated financial entities, like insurance companies. They would otherwise have to be treated as “corporates”, while the suggested risk drivers for corporates, including their calibration seem to be inappropriate for such entities and, in general, the regulated ones.

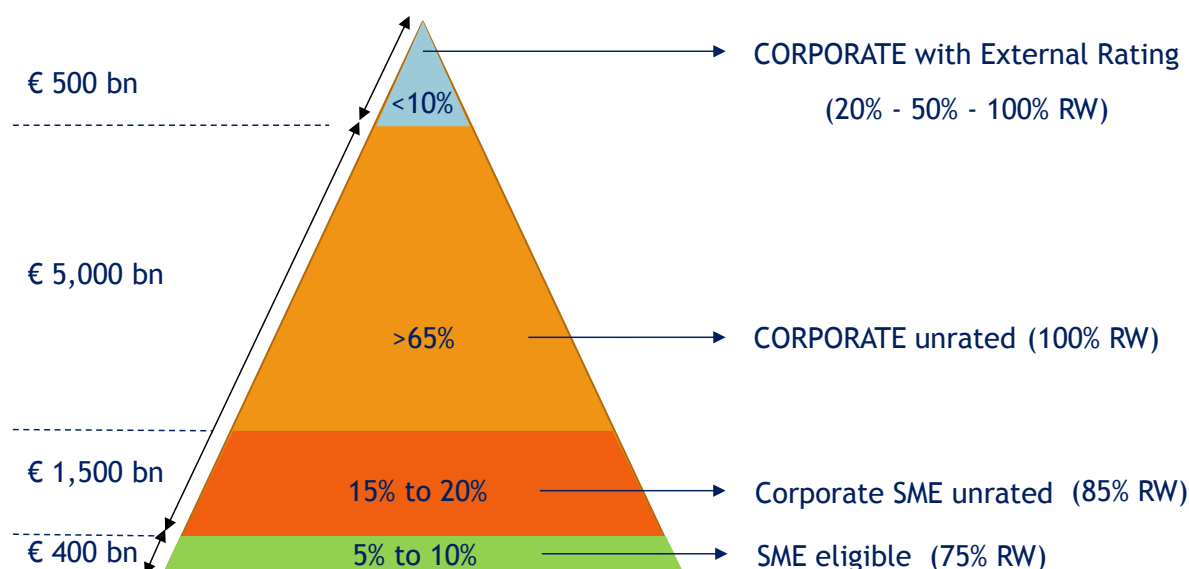


Exposures to Corporates

12. The recognition of external ratings is an improvement over the first consultative document because it contributes to a higher degree of achievement in the 3 objectives of the Committee:

- It enhances risk sensitivity at least for rated counterparties;
- It promotes comparability;
- It does not add complexity.

13. Therefore the EBF welcomes the re-introduction of external ratings for all the benefits they bring. Nevertheless, the coverage of external rating agencies for corporate counterparties is quite limited. The range of borrowers from SMEs to large corporates is very wide. According to EBF estimates and using EBA data the distribution of exposures across all types of corporates and SMEs in Europe looks approximately like this:



The fact is that less than 1% of the counterparties and only about 10% of the total exposures are externally rated. Therefore, there is a wide segment of mid-cap companies that do not have an external rating and do not qualify as eligible under the definition of corporate SME. This segment accounts for around two thirds of the total bank exposure to European companies. A 100% risk weight would restrict mid-sized corporate business, the driver of the whole economy, which is already penalised vis-à-vis other asset classes by the liquidity requirements. It is thus imperative to put in place a solution that assigns a 75% risk weight to exposures to unrated corporates that comply with the conditions set for the category of investment grade in the Standardised Credit Risk Assessment Approach (SCRA);

14. We also appreciate that within the new revised approach a risk weight of 85% for unrated exposures to corporate SMEs has been proposed. This reduces the cliff effect that the former approach was likely to entail in the case of SME exposures falling out of retail portfolio. At the same time we think that the combined effect of the: (i) 85% risk weight for unrated exposures to corporate SMEs and (ii) 0,2% binding quantitative

granularity criterion provided for retail exposures might result in an unintended disadvantage especially for smaller banks. Consequently, the application of a 75% risk weight for unrated exposures to corporate SMEs should be laid down and the granularity criterion for retail exposures should be softened).

15. The risk weight of corporate SME should be lower than the proposed 85%. The EBF proposes a 75% risk weight instead of 85%.
16. The risk weight applied to BBB+ to BBB- corporates should be revised and lowered in order to adequately reflect the credit quality of the counterparty. Indeed, the same risk weight is proposed for a BBB+ investment grade corporate as for a BB- corporate which is non-investment grade. The gap in terms of credit quality between both is significant as the first has much better credit quality than the latter, as it is also reflected in the proposed tables for MDB exposures and banks. The Committee could consider increasing risk sensitivity by:
 - Further granularity in risk weights (e.g. as in the SEC-ERBA approach in the securitisation standards);
 - Recognise a separate asset subclass of revolving credit reflecting its different nature and characteristics;
 - Include the maturity as a risk driver.
17. For a better alignment between the Standardized and IRB approaches, the special treatments already provided for purchased receivables under IRB systems should be extended to the Standardized Approach, in particular allowing:
 - the possibility to apply the risk weight of the debtor when operational requirements for purchased receivables are met (see §493 and following of the International Convergence of Capital Measurement and Capital Standards paper by the BCBS and art. 184 of the CRR), accordingly to the top down and bottom up approaches;
 - the possibility to apply the facility level approach for purchased receivables as well, extending the application of §76 of the current consultation paper as follows: "For retail exposures and purchased receivables, the definition of default can be applied at the level of a particular credit obligation, rather than at the level of the borrower. In the case of purchased receivables, every invoice is considered as a single credit obligation."
 - a preferential risk weight for exposures to unrated corporations of 75% instead of 100% when assisted by purchased receivables, in order to recognise the lower LGD of the operations guaranteed by purchased receivables², as already provided for the IRB Foundation approach (LGD of 35% instead of 45%), when the requirements are fulfilled.

We believe there is no actual reason why such approaches should not be extended to the SA. Recognition of the lower risk of purchased receivables is consistent with the aim of making the SA a valid and effective alternative to the IRB, and also to the aim of avoiding adverse selection that may push to more risky financial alternative in the

² The lower risk of factoring and commercial finance products, typical products where purchased receivables are involved, has been recently confirmed by a comparison at European level to traditional banking by the EUF in the White Paper on the factoring and commercial finance industry (2016).



absence of a correct calibration of the risk of exposures related to purchased receivables.

18. For purchased receivables that are assisted by a credit insurance contract, to provide a lower risk weight under the Standardized Approach taking into account that the historical LGD for insured receivables is not 45% but rather 35%, i.e. by applying a reduction factor of, for example, 0.75, to the applicable risk weight.

Specialised Lending (SL)

19. With respect to the first consultation paper, we do not see any significant improvement and this asset class remains among the most negatively affected, while it should definitely be the opposite: the capital burden should be cushioned to encourage the relaunch of the real economy.

Furthermore, a flat risk weight approach for this asset class is questionable: specialised lending initiatives are tailored-made and tend to differ significantly one another. The Basel Committee is expected to take into account the peculiarities of this segment and opt for a more granular approach. In this regard, risk weights should be influenced by related guarantee structures: project and object finance are frequently highly collateralized, hence mitigating the counterparty's default risk. If the Basel Committee aims at enhancing the risk sensitivity, collaterals cannot be completely disregarded. It is worth mentioning moreover that it is unwarranted to have a higher risk weight for properly collateralised SL than corporate assets even unsecured.

20. Regarding the phases, we disagree with considering separately and applying different risk weights to the pre-operational phase (150%) and the operational phase (100%) of the project finance because:

- Banks use a unique rating without differentiating between the various phases of the project. The rating does not change whether the project is at the pre-operational or operational phase. All the phases are assessed together.
- We consider the pre-operational or construction phase is unduly penalised with a 150% risk weight, which is the same risk weight as for defaulted exposures. We consider that this risk weight does not reflect the underlying risk and the low default nature of this type of financing:
 - The construction risk is highly collateralised by a lot of guarantees provided by the builder;
 - Any additional draw down on the financing is subject to the project meeting pre-agreed milestones, and the extra basis points earned during this phase;
 - In our experience, it is highly unlikely that a builder leaves a project in the middle of the construction phase, given the amount of time and resources he has invested in it. But, if he does, it would be relatively easy to replace him with another construction firm, which would profit from all the work previously done at no cost³.

³ Example: the case of Abengoa, the construction firm that is recently undergoing financial difficulties and has been forced to abandon certain project finances.



- According to the Standard and Poor's report on "Project Finance Default and Recovery Study", the pre-operational phase is not necessarily the riskiest one.

We therefore suggest to apply a risk sensitive approach similar to the slotting criteria for unrated project finance, allowing banks to assess internally the credit risk of these exposures and classify them within different risk categories or grades. When assigning risk weights to specialised lending exposures institutions could take into account risk drivers that provide a meaningful risk differentiation such as the maturity, transaction and/or asset characteristics, strength of the sponsor and developer, collaterals, etc. This approach should recognise the idiosyncratic features of these exposures and their special collateralised nature in order to adequately reflect the underlying risk profile of these assets.

21. A distinct case is that of ship loans. This type of lending has specific characteristics that make these exposures sounder than those generally considered in the SL framework. Ship loans fulfil the conditions set in paragraph 50 for real estate exposures. In particular:

- ship loans are guaranteed by first lien shipping mortgages with an LTV generally well below 80%;
- the quality of the guarantees is good. The ship secondary market is sound and liquid. On average 6% to 10% of the ships are commercialised on the secondary market every year.
- ship loans are more granular and less volatile than commercial real estate loans.

22. Ship loans guaranteed by first lien shipping mortgages should be weighted as commercial real estate exposures fixing the risk weight according to the LTV. Risk weights considered in tables 11 and 12 could be applied based on whether the repayment is materially dependent on cash flows generated by property or not.

Retail portfolio

23. We consider that the risk weight for retail exposures is not risk sensitive and excessively punitive for good quality portfolios. Therefore, the proposal could have unintended consequences as it would lead to a misrepresentation of the risk level and, subsequently, provide incentives for lower quality portfolios and inhibit the lending to the real economy. As a solution, we suggest to increase the granularity of the risk weights in order to more accurately reflect the borrower's credit quality.

The Committee should consider recognising separate asset subclasses for retail, e.g. revolving credit which would be consistent with the IRB approach segmentation and general banks' practices. For this asset subclasses, we propose to take into account additional drivers in order to enhance the risk sensitivity. For instance:

- Variables directly linked to the behaviour of a particular product/customer.
- Variables associated with the length of the relationship with the customer.



- The maturity of the exposure. Both intuition and empirical evidence indicate that long-term credits are riskier than short-term credits. As a consequence, the capital requirement should increase with maturity.
- The presence of physical collaterals. We believe that the framework should recognise the risk mitigating arrangements included in certain retail transactions, such as leasing and loans collateralised by durable goods (e.g. reservation of title in financing vehicles). According to research available⁴ the default and loss rates for leases are significantly lower than for traditional lending. According to the latter study, which was based on a portfolio of 3.3 million lease contracts in 15 European countries, one-year defaults on leasing Retail SME exposures were 2.7% compared to 4.5% for all Retail SME lending in 2010. Similarly, Loss Given Defaults for leasing were 19.6% compared to 33% for all Retail SME lending.

Comments on the definition of SME

24. We appreciate that the new consultative document introduces a definition of SME (reported sales for consolidated group less than €50 million). Exposures to SMEs where personal guarantees are given should qualify as part of the regulatory retail portfolio.

Regarding the granularity criterion

25. The BCBS rightly considers the diversification criterion to be one of the primary justifications for the current preferential treatment. However, adopting a ‘one-size-fits-all’ approach in this area, and setting a very low threshold, is likely to result in unintended negative consequences. Indeed, for institutions with small portfolios the proposed thresholds can be reached very easily. Therefore, small business-retail customers of smaller banks would be strongly discriminated and competition within the banking sector is likely to be distorted via the prudential regulation.
26. This can entail significant drawbacks. In particular the specific business model of small banks based on traditional lending activity (so called relationship lending) might be negatively affected by the prudential regulation mainly for a twofold reason:
 - the ‘too-small-to-survive/succeed problem’ would be exacerbated due to regulatory-induced incentives to grow in size (while in some cases merger operations are the principal way to increase efficiency and strengthen the resilience of very small banks this principle cannot hold true for every case);
 - ‘Multiple banking relationships’ can be one of the banks’ reactions. As a result the commitment of the bank towards the SME borrower would be weakened and in turn the pursuit of the typical benefits of the relationship lending would be jeopardised.
27. Offering national discretion as an ‘emergency exit’ (section 1.4 footnote 10) contradicts one main objective of SA review mentioned, to reduce national discretions. It is imperative for the growth of regional economies to maintain the availability of credit to retail individuals by smaller credit institutions. In some cases, the market area of credit

⁴ The Risk Profile of Leasing in Europe: The role of the leased asset (Deloitte).



institutions is even restricted to a very limited number of municipalities. The proposed 0.2% of granularity criteria would impose harsh constraints on credit availability, and puts pressure on supervisors and policy makers to ensure that local economy is unharmed by imposing relatively too strict thresholds.

28. We believe that the granularity criterion should be maintained as a qualitative requirement and national discretion should be allowed to detail it. Otherwise, a granularity threshold of at least 2% would be needed.
29. A proportional approach could be envisaged for credit institutions with a retail portfolio (without taking account of the granularity criterion) below a certain threshold (e.g. €500 million) to be subject only to the loan size criterion removing 0.2% granularity criterion.
30. We agree with the indication of footnote 40 that no circular calculation has to be made and that the granularity criterion is to be verified only once.

About the loan size criterion

31. As for the threshold value of individual exposures, we believe that it should be raised to €1.5 million (the existing level was determined at least 12 years ago) and adjusted to inflation on a regular basis.
32. With reference to specific products that have different risk characteristics, compared with other retail exposures, we propose a specific supervisory treatment for Salary Secured Loans and Pension Secured Loans⁵. This technical form of consumer credit is supported by a series of guarantees that reduce the credit risk in comparison with other forms of retail loan. These guarantees include:
 - (i) direct assignment of one-fifth of the pension or salary to cover payment of the loan instalments;
 - (ii) mandatory insurance policies (“life cover” for loans involving the assignment of one-fifth of pension and “life and loss cover” for transactions involving the assignment of one-fifth of salary);
 - (iii) transfer of the effects of the assignment of salary to the pension when the borrower retires;
 - (iv) restrictions on access to the retirement bonus and/or similar indemnities, with immediate recourse available to the creditor;
 - (v) restrictions on possible attachments and seizures of the salary/pension that guarantee the privileges of the lender in comparison with other creditors.

According to the relevant risk mitigating characteristics of Salary Secured Loans and Pension Secured Loans, a favourable prudential treatment should be applied with respect to alternative forms of consumer credit. The evidence of a low level of credit

⁵ As an example, the Italian “Cessione del quinto dello stipendio/pensione” that is regulated by the Ministry of the Economy and Finance and the Bank of Italy.



risk is supported by the outcome of a sample survey⁶ carried out by EBF that, with reference to pensioners and public employees, showed that:

- the probability of default (PD) within 12 months is 3.0%;
- there is 32.6% return to performing status within one year;
- the effective loss rate (weighted-average LGD rate) is 5.8%⁷;
- the expected loss (EL) is 0.16%.

In view of this evidence, it is requested that Salary Secured Loans and Pension Secured Loans be recognised as less risky than retail portfolio loans and deserve a lower risk weight than that of the general retail portfolio (75%). According to the evidence shown above the EBF suggests that an appropriate risk weight should be set in the range 35%-50%.

Residential Real Estate

33. We believe that there should be scope for local calibration of risk weights associated with the different risk buckets by national authorities based on documented loss rates over time *in jurisdictions where structural factors result in sustainably low credit losses associated with the exposures to the real estate market*. A study by the European Banking Authority of 43 EU IRB banks across 14 different EU jurisdictions showed an average median risk weight for loans beneath 85 % LTV of well below 15 % for all years 2001 to 2012⁸. The sample included banks in both high loss and low loss jurisdictions in that period. The maximum risk weight for all banks in the sample across all 14 jurisdictions was above 40 % in only 5 years in the 2001-2012 period. These risk weights are based on very substantial data underlying PD and LDG estimation and calculated by using the formula given in the Basel III standard. This clearly indicates that the proposed risk weight of 35 % for loans below 80 % LTV does not reflect *appropriate risk weights in jurisdictions where structural factors result in sustainably low credit losses*. An appropriate conservative starting point for risk weight in low loss jurisdictions would be below 20 % for loans beneath 80 % LTV. Reduced risk weights could be applied, where in the opinion of the appropriate competent authority, expectation of low credit losses can be demonstrated given analysis combining historical experience, future expectations, potential risks, the macro-prudential environment and lending policies of the institution.
34. We note that the performance of real estate mortgage exposures leads to sustainably low credit losses in several jurisdictions. The Committee should investigate and include in the risk weighting function the underlying factors that explain such a performance, for example: to what extent the borrower is liable for the remaining debt if the collateral is sold at a price below the loan balance or to what extent residential mortgages are combined with special guarantees or insurances, including with government backing. In

⁶ Eleven of the twelve intermediaries referred to in note 2 participated in the survey described below, providing over 80% coverage of 2013 loans guaranteed by the assignment of one-fifth of salary or pension.

⁷ The weighted-average LGD rate was provided by a sub-sample of 7 respondents.

⁸ Report on residential real estate and financial stability in the EU. European Systemic Risk Board. December 2015



particular, sovereign guarantees are an effective mitigation factor that should be recognised. Evidence indicates that these kinds of guarantees significantly reduce the LGD. The concerned covered loan parts should be risk weighted accordingly. These are critical factors in the determination of risk in many jurisdictions.

35. The EBF supports the option of Loan Splitting (LS) versus Whole Exposure (WE) in the allocation of Exposure At Default (EAD) to Loan To Value (LTV) buckets. It can be argued in favour of LS that:

- It avoids cliff effects as marginal increases in LTV would lead to disproportionate increases in RW;
- There is an undesirable incentive to split the loan between different entities in case that the LS option is not recognised;
- In any case, neutrality should be maintained.

36. The EBF defends that the value of the property should be regularly updated to account for changes in the market value and make the LTV factor more risk sensitive. This would maintain the level of risk sensitivity in the framework as time passes from the date of loan origination. Moreover, the proposed approach would eliminate undue incentives to regularly change provider of mortgage loans.

37. The loan splitting also better reflects the risk associated with junior liens as the risk weight of higher LTV bands increases accordingly.

38. The EBF believes that more granularity in lower levels of LTV (below 40%) would be warranted and simple.

39. The comparative risk weight across asset classes gives way to counterintuitive cases. For instance, exposures collateralised with residential real estate (where repayment is materially dependent on cash flows generated by the property for commercial and residential real estate) with LTVs above 60% have a risk weight ranging between 90% and 120% whereas unsecured retail exposures have a risk weight of 75%. We suggest taking into account the risk weight of the counterparty as the maximum risk weight applicable for exposures secured by real estate.

40. The proposal for mortgages where repayments are materially dependent on cash flows generated by the property will significantly increase the capital requirements, impacting on the cost of this lending and therefore on the ability of the banking sector to provide credit. We consider that these exposures are unduly penalised and capital levels go significantly beyond the risk incurred:

We are concerned about the significant increased risk weights for Buy-To-Let (where 'repayments are materially dependent on cash flows generated by the property') of 70% - 120%. In some jurisdictions core Buy to Let lending typically involves high financial quality landlords, where ultimate risk levels are regarded as being no worse than residential mortgage lending. Therefore, we suggest:

- a. To include conditions which, if met, would allow the use of the lower regular Mortgage risk weights of 25% - 55% for high quality Buy to Let lending.



- b. To increase the granularity of the risk weights at least with the granularity provided in table 9 because marginal increases in LTV would lead to significant increases in risk weights.
41. In general we consider that the differentiation of assigned risk weights across grades should be wider. Specifically, to achieve risk sensitivity, the same risk weight should not be assigned to two consecutive grades. Also some of the tables should be extended at both ends in order to better reflect the risks in banks portfolio. Concentrated risk weight tables will in a little extent reflect any risk.
42. All in all, we need to make a proposal for a phase-out period on the basis that the impact on current borrowers should be limited and banks should be given enough time to adapt their lending conditions to the new rules.

Commercial Real Estate

43. Also for commercial real estate we ask to adopt the option of Loan Splitting (LS) instead of the Whole Exposure (WE) option in the allocation of EAD to LTV buckets. A specific analysis conducted on the non-residential real estate leasing market demonstrates that:
- the total RWAs resulting from the application of the Whole Exposure (WE) rule would be disproportionate as respect to the total RWAs that would result by applying the IRB approach to the same contracts;
 - total RWAs resulting from the application of the Loan Splitting (LS) rule would still be more prudential than those resulting from the application of the IRB approach.
44. In its current proposal, the BCBS strongly penalises commercial real estate exposures. There is a poor recognition of the mortgage-enhanced security. Real estate secured exposures appear to be treated as a separate asset class. It is in fact hard to reconcile the discrepancies in the risk weights across classes of exposures. Commercial real estate exposures with a LTV over 80% receive a higher risk weight than unrated (unsecured) corporates exposures. Unless there is consistency between risk weights across different exposure classes, lenders may be incentivised to not to incorporate the benefits of collateral for prudential purposes.
45. It is important to highlight that commercial properties represent important credit risk mitigation instruments for SMEs.
46. We propose to maintain the current risk weights for commercial real estate exposures at least in those cases where repayment is not materially dependent on cash flows generated by property.
47. Similar to residential real estate there should be a national option to include lower risk weight where there is evidence showing that the market is well developed and long-established and where common loss rates threshold may be set.

Land acquisition, development and construction (ADC) exposures

48. Small scale home builders deserve a distinct treatment as the risk profile is significantly lower than that of speculative building development.



Similarly, we believe that land acquisition, development and construction (ADC) exposures are unduly penalized. These exposures are risk weighted at 150%, which is the same risk weight as for past due exposures. In order to increase risk sensitivity, we think that the Property Development should take into account the security value, with tiering based on LTV. Furthermore, risk mitigation techniques such as 'pre-selling' should also be recognised, and an ongoing risk assessment over life of project should be allowed.

The proposal strongly penalises the development of the real estate market in terms of Land acquisition, development and construction (ADC) exposures. According to this proposal, these kinds of exposures are classified with the same risk weight of "defaulted exposures". The adverse consequences of this proposal could reduce the capability to grant these loans, with a general increase in interest rates affecting borrowers and indirectly also affecting their creditworthiness, in terms of the sustainability of instalment payments. We propose an important reduction of risk weights, classifying the exposure according to the nature of borrower, even if the mortgage is not recognised as eligible credit risk mitigation.

Risk weight add-on for exposures with currency mismatch

49. We do not agree with the proposed risk weight add-on for exposures with currency mismatch. We believe that the proposal could have asymmetric effects. The impact will be different across jurisdictions and at different points in the economic cycle:
 - a. The proposal does not recognise a proportionate approach with regard to the add-on. For instance, if a corporate earns its main revenues mostly in a given currency (for instance Euro), any loan in a different currency whatever the amount of the loan will be subject to this risk weight add-on. Take for example the corporate EXXON (AAA rated), whose main revenues (\$394bn) are in USD: a \$100 million loan to this company in a different currency will induce an additional risk weight of 50% and ultimately a risk weight of 75%. Is this loan riskier than any other USD exposure to this company? We believe not.
 - b. The add-on could have a relevant negative impact in emerging economies. We consider that the proposal should take into account that companies from the many "dollarized" economies can transfer this currency risk to their customers and suppliers.
 - c. In the case of exposures to corporates, we consider that such credit risk is already considered as part of the external rating and due diligence requirements, and thus, will lead to double counting of such risk. Therefore, we suggest not to apply this add-on to corporates exposures.
 - d. As EU/EES integrates it becomes increasingly common that households own a property situated in a country with another currency than the currency of the household's income. This could for instance be the case with families living close to borders between countries in EU/EES with different currencies and having their home on one side of the border and earning their income on the other side of the



border⁹. Another example is when families have a vacation house in another country than in that where it earns its income¹⁰. In many of these cases it is common that if the property is financed with a mortgage loan, that loan is denominated in the same currency as that of the country where the property is situated. This practice has developed because the financing banks deem it too risky to provide a mortgage loan in a different currency than the currency of the country where the property is situated. This is because history tells us that from time to time exchange rates may change significantly within a short time period without having much impact on property prices.

In order not to punish banks from applying this from a risk management sound principle the add-on for loans denominated in another currency than that of the borrower's income should not be applied on mortgage loans where the loan is in the same currency as that of the country where the property taken as collateral is situated. We therefore propose that the wording of paragraph is changed in the following way:

63. For the purposes of paragraph [62], unhedged exposure means an exposure to a borrower that has no natural or financial hedge against the foreign exchange risk resulting from the currency mismatch between the currency of the loan and the currency applied to pay down the loan. A natural hedge exists where the borrower, in its normal operating procedures, receives foreign currency income that matches the currency of a given loan (e.g. remittances/export receipts) *or if the exposure is secured with a property located in the country having the currency of the loan as its national currency*. A financial hedge generally includes a legal contract with a financial institution (e.g. forward contract).

50. We are concerned about the statement that “the existence of Currency Mismatch should be part of the global assessment through the due diligence” because:

- a. This means that banks will have to check, for each facility, that there is no currency mismatch, even if the borrower is established in the country of the currency of the loan. From an operational point of view this will be highly burdensome.
- b. It does not introduce any proportionality: If a corporate has its main revenues, but not all, in a given currency, it means that any loan in a different currency, whatever its size will be subject to an additional risk weight.
- c. A loan in USD to a counterparty whose main revenues are in EUR will be subject to an additional RW, a loan in EUR to the same counterparty who makes a USD/EUR cross currency swap will have no additional RW while the risk is the same for the lender. Such additional requirement will induce an increase of the financing cost for middle market corporate that need to borrow foreign currency to develop their activity in new foreign markets where they do not have yet existing revenues. The

⁹ This is, inter alia, common in the Danish-Swedish Örestad region around the Öresund bridge between Malmö (Sweden) and Copenhagen (Denmark), along the Swedish-Norwegian border along the Swiss-EU border and along the eastern border of the Euro zone or when people (e.g. construction workers) are working abroad on a semi-temporary basis earning their income in a different currency than that of their home country.

¹⁰ E.g. British citizens having a vacation dwelling on the continent or German or Danish citizens having a cottage in the southern part of Sweden.



corporate customer can have many other FX exposures under other means than loans in currency mismatch.

The ultimate difficulties posed by the proposal on currency mismatch can be illustrated in a practical example:

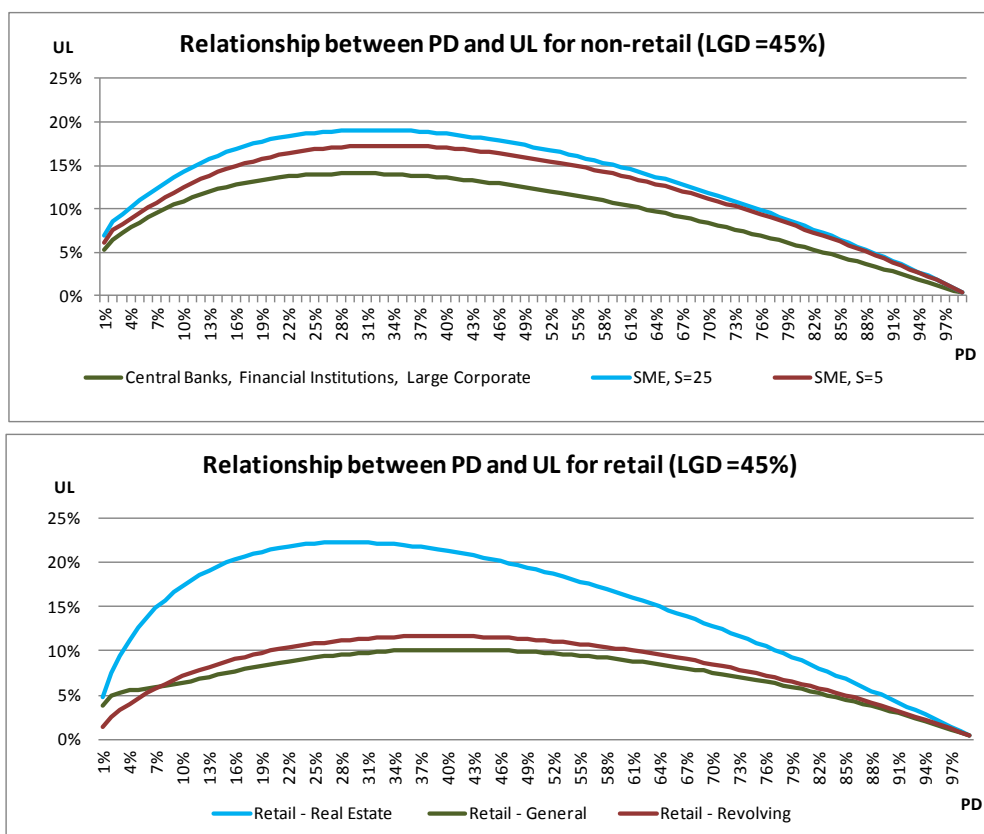
Let's assume that a middle market retail company wants to open a subsidiary in a new country. For this development they need to rent offices, shops and to buy equipment locally. Thus they need local currency resources to cover this outlay. The spending will be repaid by the revenues generated locally and thus the company will need to borrow in local currency but since the main currency of the borrower is not this local currency the lending bank will apply a 50% add-on to the loan which will be reflected in the final pricing: This add-on will be an obstacle for the international development for middle market companies. Worse: it will push these companies to borrow in their national currency and thus create a currency mismatch between their revenues (in local currency) and their debts.

Treatment of past due

51. Although we agree that in the current framework the specific provisions have a double effect through the reduction of the exposure amount (Net EAD) and the reduction of the risk weight (100% if the specific provisions represent more than 20% of the outstanding amount), we believe that the current framework is totally aligned with the IRB framework.
52. The IRB capital requirement formula is based on a very important principle: The capital requirements reflect the unexpected loss through the deduction of the expected losses from the VaR estimate (with a confidence level of 99,9%).

Based on that and starting on a specific inflexion point, when the PD increases the capital requirements start to decrease as the expected loss is already high, "leaving" less space for substantial unexpected losses. This can be observed in the following illustrative graph:





This principle is also acknowledged in the assessment of the risk weight formula for exposures with a PD = 1 (defaulted exposures): $RW = \max(0; 12,5 * (LGD - ELBE))$.

In this case, being ELBE an approximation of the impairment provisions (if not, any positive difference would be deducted to CET1), there is a strong incentive to include stressed macroeconomic conditions on impairment calculations (as already proposed for IFRS 9 purposes and also on CP/2015/36 by EBA) in order to minimize the difference between the LGD (of defaulted exposures) and the ELBE estimate.

In summary, all IRB framework is constructed in a principle that for defaulted or quasi-defaulted exposures (higher PD), the capital requirements are reduced as they represent unexpected losses that, from a specific point, start to decrease as the expected losses increase. However, although is acknowledge by BCBS the need to align both frameworks in page 17 ("From past due to defaulted exposures"), the proposed exclusion of the provisions as a driver for the standard RW will create an inconsistency between STD and IRB frameworks, which will originate again a departure from the IRB framework.

In conclusion, provisions should be considered when determining the risk weight.

53. Since the Basel Committee is currently involved not only in the revision of the standardized model for credit risk, but also of the IRB, we would recommend the regulator reassesses the risk weights for defaulted exposures after the review of the internal models, in order to calibrate them in line with the considerations done for the IRB for the sake of consistency. This would enhance the overall simplicity and the comparability across banks.



Besides retaining the current approach based on the level of provision, we consider that for acquired defaulted exposures where the asset value (net booked value) is equal to or lower than 80% of the remaining nominal exposure, the amount shall be risk-weighted at 100%.

54. There is no double benefit in the current risk weight, due to the effective write down, in acquired defaulted exposures. Trades of defaulted exposures are done on a relatively active market, typically in auction like settings. Acquirers are often, but not always, non-regulated debt collection companies. The net booked value of defaulted exposures include the value of the asset, as well as an acquisition margin and the effective write-down.

$$\text{Nominal amount} = \text{Asset value} + \text{acquisition margin} + \text{effective write down}$$

55. Is there a difference in risk between performing credits and acquired defaulted exposures? Thorsell¹¹ finds that there is an excess return on defaulted corporate bonds, meaning that a portfolio of corporate bonds, after re-valuation have a higher return than can be explained by their riskiness, i.e. he finds that defaulted corporate bonds typically trade at a discount, and are less risky than could be expected. Furthermore, the difference in market beta between ex-post non-defaulted bonds and defaulted bonds are insignificant in the GARCH (1,1)¹² specification (0.0855 vs 0.0843). This means that the asset quality for an acquired defaulted exposure is similar to a corporate credit, and should have a similar risk weight.
56. The threshold level of at least 20 percent in provision, write down or acquisition margin for a lower risk weight (100% instead of 150%) in the current standardised approach for credit risk can still be relevant as a threshold level for acquired defaulted exposures meaning that the Asset value in above formula can be maximum 80% of the Nominal amount, since that is an indicator of a sound buffer for unexpected losses.
57. We propose to amend §75 adding the following to the first bullet point: *"Any material credit obligation is past due more than 90 days or 180 days for purchased receivables to Sovereign and Public Sector Entities. Overdrafts will be considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current outstanding. Purchased receivables will be considered as being past due once the expected payment date has passed, unless there is evidence that the delay of the payment is due to commercial reasons other than financial difficulties of the buyer (i.e. disputes, payment flexibility, reconciliation processes, verification procedures etc...)"*.

Off-balance sheet items

58. The concept of unconditionally cancellable commitments (UCC) was introduced in 1988 and it has never been reviewed since. As far as the level of 0% was in place, the definition of UCC was of no importance. Now that the Basel Committee has decided to

¹¹ Thorsell, H. "The Pricing of Corporate Bonds and Determinants of Financial Structure." PhD Dissertation, EFI, Stockholm School of Economics, 2008.

¹² The GARCH (1,1) specification is the relevant comparison since it lessens the impact on the estimate from the default itself.



apply a CCF different from 0%, the BCBS should clarify what is a commitment and what is not a commitment in the banks' practices. The application of a CCF higher than 0% for UCCs raises many questions since the concept of commitment that can be cancellable at any time without conditions is somehow contradictory: If a bank can cancel the so-called commitment, in practice the bank is not committed *stricto sensu*, thus one should not consider that this UCC is a commitment.

Moreover in some jurisdictions these situations (the so-called UCC commitments) are not reported in financial accounting:

- This is the case under IFRS norms;
- The current framework is based on an alignment of risks exposures on accounting figures;
- This was not an issue due to the absence of capital charge thanks to the 0% CCF.

We think that the Basel Committee should confirm that accounting reporting should remain the unique reference for the calculation of risk weighted assets and not open any room for a divergence between the accounting reference and the risk perimeter. In particular, we would recommend splitting retail category in two, distinguishing individuals from small business, introducing a lower CCF for the latter whose credit exposure is well monitored within the internal risk management process.

In the following development we will consider the true UCC, i.e. the commitments cancellable at any time without conditions, without prior notice.

59. Reputational risk consideration has no link with UCC:

The Basel Committee in its consultation paper invokes the reputational risk as a factor that could force a bank to execute an UCC:

- The reputational risk is not to be covered by the standard approach for credit risk (this is by the way currently addressed through the step-in risk consultation)
- Corporate clients are happy with UCC because they don't pay for it (Banks and their clients don't consider it as a service). As a consequence corporate client are fully aware of the revocable characteristics of the UCC. On the contrary when the corporate needs a firm commitment (for instance in order to fix the cost of financing or because it will improve its external rating or to fix the operating conditions of a commercial project) he is ready to pay for it. Thus both parties are fully aware that they are not committed and corporate clients accept this risk: reputational risk cannot be invoked to consider that banks are likely to authorize a drawing of their commitments by their clients though a credit deterioration.

We think that, granting to corporate clients an uncommitted line, revocable without condition and without prior notice, relates to internal management of credit risk by the bank since:

- the credit line authorisation is materialised only through an internal credit limit (no accounting treatment);
- there is no contractual commitment toward the client;
- the situation may be re assessed prior to the drawing by the client depending on the set-up;



Put a capital charge on such situation is equivalent to calculate a capital charge on future exposure (for instance a future new loan to a future new customer). As far as the bank retains the capacity and the right to cancel its commitment, the Committee should consider that if the bank agrees any drawing of funds by its customer this is a management decision due to a new situation rather than the consequence of a supposed obligation of the existence of a UCC: there should not be a direct link between the UCC and any utilisation of a line.

As a comparison, assigning a capital charge to the UCC would be equivalent to assigning a capital charge to a bank for its future (but not yet occurred) exposures, i.e.:

- If a Bank wants to develop its credit activity in a new market and knows that it will have future credit exposures on this market;
- An internal market risk limit that is not used;
- A credit Committee decision to authorise an envelope for a client, a country, etc.;
- The prospection for the creation of a commercial relation with a client with an internal limit to start the discussions with the client.

60. Since the Basel Committee has decided to apply a CCF different from 0%, we think it necessary to clarify what is a commitment and what is not a commitment in the banks' practices. The Unconditionally Cancellable Concept could cover many realities:

- Commitment revocable to the full extent allowable under consumer protection and related legislation;
- Commitment automatically revocable in case of deterioration of the borrower's creditworthiness;
- Written document given to the client where the banks open a credit line and states that it can cancel its commitment to lend at any time without prior notice and without conditions;
- Oral commitment to the customer, stating that the bank can cancel it at any time;
- Past overdraft, authorised by the bank, without any written document sent to the client (i.e. the bank has granted an authorization to draw but can refuse at any time any new drawing, but no contract exist);
- Credit limit decided by the credit committee, orally communicated to the client or not;
- Counterparty risk limit;
- Market risk limit.

Thus we urge the Basel Committee to review the definition and concept of Unconditionally Cancellable Commitment and to clarify the boundary between commitments and other situations that should not attract any capital charge, in particular to confirm that the alignment between accounting and risk has to be fulfilled in regard to UCCs.

61. Our base proposal is as follows:



- The Basel Committee should confirm that only off-balance sheet commitments that are reported in the accounting framework should enter in the risk weighted assets calculation framework;
- In particular the Basel Committee should confirm that internal credit limits should be excluded from the RWA framework;
- Regardless of the conditions (consumer protection law, cancellable in case of credit deterioration), UCC should attract a 0% CCF as far as the client cannot draw the commitment without an action from the bank.

62. Alternatively, the following considerations should be taken into account: We believe that the proposed treatment for off-balance sheet items contradicts the Basel Committee's message that "increasing overall capital requirements under the standardised approach is not an objective". In particular, the proposal to increase the CCF (from 0% to 10%-20%) for commitments that are unconditionally cancellable unduly penalises these retail exposures. This could have a significant impact mainly on corporate financing and in credit cards. We therefore suggest maintaining the current CCF of 0% as there is no evidence that banks are inadequately capitalised for the risks created by offering such commitments.

63. Corporate unconditionally cancellable commitments (UCC) are excluded from the preferential treatment set out in paragraph 69 of the consultation document. Given the evidence from first QIS on 2014 consultative document (*"the average CCF estimated under Advanced IRB for unconditionally cancellable commitments is higher than the proposed (10%) CCF, although there were large variations between countries"*), a different treatment between corporate and retail UCC is not justified. In the EBF's opinion UCC to corporates should be applied the same CCF as retail.

64. Moreover, in order to enhance risk sensitivity and strengthen the link between the standardised approach and the internal ratings-based approach, we propose including the credit/revolving utilisation ratio as well as the commitment's maturity and product as additional drivers to determine the CCFs of commitments not unconditionally cancellable:

- a. Commitment's maturity is an important driver that is already captured in the current standardised approach and in the IRB approach. We suggest applying different CCF depending on the commitment's maturity and the product, in order to ensure a risk sensitive approach.
- b. Credit/ revolving utilisation ratio, which represents the credit balances relative to the credit limits on the revolving facility, should be calculated not only at aggregate level but also individual level, as long as the card/facility is still open.

65. Regarding the 50% CCF proposed for transaction-related contingencies in trade finance, we consider that:

- a. It is necessary to provide a formal definition of transaction related contingencies for products which fall within the scope of this definition, along with recognition that products may share overarching limits. This harmonisation would ensure consistency and comparability across institutions.



- b. The risk and possibility of these items to be converted on an on-balance sheet exposure depends on whether the guarantee is covering a pure payment obligation or credit substitute (financial guarantee, where a higher CCF will be required) or whether its execution is contingent to the technical performance of a commercial contract (performance bond) or the decision of a court or customs/tax authority (middle risk). Given that the execution of performance/medium risk guarantees depends on a non-monetary event, a lower CCF than the 50% proposed should be applied. In this context, it should be noted that as transaction related contingencies are off-balance sheet exposures, applying a CCF value is necessary not only to derive the on-balance sheet exposure value of these exposures but to the extent they are structured as facilities/limits the CCF value is also applied to determine the level of commitment to make the undrawn part of the facilities available. In these cases, where underlying exposure already receives a lower CCF (i.e. 20%) the CCF applying to the committed amount should receive a lower CCF than the drawn amount.
66. We suggest the following change to §68: "A 20% CCF will be applied to both the issuing and confirming banks of short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment) as well as for factoring and invoice finance commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness." Factoring and receivables finance indeed have a short term and self-liquidating nature and can be assimilated to trade finance.
67. Moreover, due to the accounting framework (this is the case for IFRS jurisdictions), commitments that are cancelable at any time without conditions, without prior notice do not appear in the accounting reporting: Should Banks continue to align their risk perimeter on the accounting reporting and thus ignore those commitments?

Equity and subordinated debt

68. We believe that a distinct treatment for the banks should be recognised, taking account of some features laid down by existing prudential regulation for these issuers. Such a distinct treatment could be substantiated for instance in the recognition of a 100% RW to the regulatory capital instruments (CET1, T1 and T2 instruments) issued by a bank compliant with the minimum capital requirements and the MREL indicator. In particular, a 100% RW should be recognized, by virtue of the fact that the issuer of the instruments is a bank already compliant with capital prudential and resolution requirements.

Credit risk mitigation (CRM) techniques

69. It is inconsistent that CRM, which is eligible in the IRB approach, is not eligible for the SA approach. Credit risk management and application of credit risk mitigation techniques are part of core banking activity and subject to strict operational and legal requirements and it seems inconsistent with the aim of making the SA more risk sensitive that collateral subject to prudent valuation and legal requirements is not



recognised. Furthermore it should be commensurate with a risk sensitive capital adequacy framework that the range of collateral that is eligible in each jurisdiction is acknowledged. Such a treatment should at least be possible subject to the approval of national supervisors. The suggested treatment should not complicate the SA as the related collateral routines are part of banks' normal activity.

70. The point was made that collateral in auto-loans and consumer credit has a value and could be computed for CRM purposes. It seemed to be a weak case at first sight, but it could gain recognition if well elaborated by members. Our suggestion is to separate types of guarantee: Consumer credit like white-line (e.g. washing machines) is a very weak case, but auto-loans could be defended. It is a significant portfolio across the EU and there must be data available from banks and carmakers industry.

71. The treatment of shares of UCITS/mutual funds under the Comprehensive Approach should be made more risk-sensitive. The prudential treatment applied to shares of UCITS/mutual funds pledged for Credit Risk Mitigation (CRM) purposes under the Comprehensive Approach is a very relevant topic for the banking industry. Indeed, collateral in the form of shares of UCITS/mutual funds is widely used by customers, who appreciate the quality, the stability and the liquidity of these well-regulated investment vehicles.

The current prudential framework, as well as the one under consultation, recognises shares of UCITS/mutual funds as financial collateral. For the purpose of the look-through approach, such collateral is considered eligible if the shares have a daily public price quote and if the UCITS/mutual funds are restricted to solely invest in other assets eligible under the CRM (§ 92 and § 104 of the Consultative Document).

We believe that the latter condition is too restrictive because it constitutes a binary approach, where UCITS/mutual funds holding a limited percentage of non-eligible assets have no value for the CRM. For example, if only one of the assets held in portfolio by a UCITS/mutual fund is not eligible, then the whole portfolio is deemed non-eligible. This "all or nothing" methodology excludes from the CRM eligibility a broad range of UCITS/mutual funds, thus reducing the borrowing capacity of customers and the lending capacity of banks.

In order to introduce a more risk-sensitive framework, we recommend that banks be allowed to apply a partial look-through on the eligible assets held by the UCITS/mutual fund. As a safeguard to the recognition of this partial look-through, we also suggest to limit the percentage of non-eligible assets held by the UCITS to a maximum of 50% of the total portfolio.

72. The new standardised approach for measuring counterparty credit risk exposures includes the collateral posted in the EAD formula and therefore these guarantees, cash or securities, are not subject to credit risk charge. Even the formula for calculating the EAD for SFT with GMRA (Par. 164) recognizes the side in both directions, received and paid. For these reasons we ask to delete the phrase "as will the posting of securities in connection with derivatives exposures or with any other borrowing transaction" in paragraph 129 of Annex 1.

73. We ask to clarify the scope of application of the paragraph 146 in Annex 1. In our opinion it should be applied to transactions which do not generate counterparty credit risk. Indeed in this formula "C" is equal to the current value of the collateral "received", while



the collateral is considered in both directions to calculate the EAD for counterparty credit risk.

74. The BCBS should consider the risk mitigating arrangements included in the following retail transactions:

- Loans collateralised by autos: we consider that the second hand auto market is very liquid and countercyclical. The collateral can be converted into cash in a short timeframe and the sale of second hand autos increases during crises.
- Loans paid by receivables (e.g. commercial, service and credit card receivables, payroll payments, rents, long-term public concessions).

75. In addition, for exposures to Multilateral Development Banks, we think that clarity on the treatment of credit risk mitigation from Export Credit Agency (ECA) and Private Insurance products should be provided:

- In particular, for ECA credit risk mitigation techniques that meet the criteria of an eligible guarantee, it should not be an issue of whether the ECA credit risk mitigation technique is “styled” as a guarantee or as an insurance product.
- Private Insurance should be explicitly recognised as an eligible credit risk mitigation technique (subject to meeting the criteria of the personal guarantees). This inclusion would be useful for the sake of clarity given that it was already acknowledged in the QIS Frequently Asked Questions (as of 20 December 2002).

