Federcasse Comments on the Consultative Document of the Basel Committee on Banking Supervision *"Revision to the Standardised Approach for credit risk"*

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1. General remarks

Federcasse, on behalf of Italian Banche di Credito Cooperativo (BCCs), welcomes the opportunity to comment on the Consultative Document (CD) by which the Basel Committee on Banking Supervision (BCBS) launches the review of the standardized approach of credit risk (SA).

In principle we agreed on the objectives of keeping the SA as simple as possible, increasing its risk sensitivity and linking it to IRB approach without resulting on an overall increase of capital requirements. However, we note several criticalities on key aspects that call further relevant insights and a careful balance among key policy objectives of equal importance as for example, the level playing field, the financial stability and the bio-diversity both in the financial and non-financial sector.

In general, any changes in the SA should be clearly limited to those areas where it has become clear, after a thorough assessment, that the current framework underestimates the risk.

While we highly appreciate the statement that the objective is not to increase overall capital requirements, we note that the values of the parameters and factors proposed decisively point in the direction of a significant capital increase. Moreover, other consultation processes strictly related to the SA review have been carried out (e.g. Counterparty Credit Risk for OTC derivatives) or are still underway (e.g. Fundamental Review of the Trading Book) which could also result in an increase of the overall capital requirements.

In this regard, the overall calibration of certain requirements (*e.g.* corporates, retail and residential real estate), is likely to be much more burdensome for smaller banks, as the financing of small and medium enterprises (SMEs) and households may cover a higher proportion of their portfolios. As a result, the joint effect of some measures (*e.g.* those related to corporates, retail) may even amplify restrictions on financing. Indeed, the calibration of certain elements implies general policy choices that go beyond risk management indications, in particular: (*i*) a potential further restrictions of access to funding for SMEs, against a preferred treatment for large corporates; and (*ii*) a pressure towards consolidation to achieve greater size for banks (*e.g.* the hardened granularity criterion for retail exposures).

Furthermore, some element of the proposed review go in the direction of increased procyclicality, as a worsening of the economic scenario would have a detrimental impact on the risk drivers to a greater extent than currently envisaged.

While the BCBS designs, in principle, the rules of the SA for internationally active banks, this standard will be relevant even for the smallest banks. In fact, in many jurisdictions (*e.g.* in the EU) the rules will be directly applied to all institutions generally adopting a 'one-size-fits-all' approach. Since the SA is the unique method for the calculation of capital requirements for smaller banks, it should be simple and easy to handle in the first place. We suspect that the proposal fits these requirements; indeed the evaluation and monitoring of the different risk drivers (very often on an ongoing basis), the generation, collection and administration of numerous data and the increased complexity of calculation method will in fact imply serious challenges which will be particularly acute for smaller institutions.

Regarding the objective to reduce or remove the reliance on external ratings we would like to ask the BCBS to partially reconsider its point of view. Even during the crisis, the ratings of banks and corporates remained reliable and since then many improvements were introduced. It seems odd to determine capital requirements for exposure to banks and corporates from the perspective of a very simplistic two-dimensional approach, while ratings from external agencies deliver a much more detailed and precise picture. We therefore believe that the use of external ratings of banks and corporates should remain, along with the option of using the sovereign method for unrated banks which, alternatively, should at least have more appropriate risk drivers and calibrations with better definition and testing than the one proposed. We would like to recall as well that the new Basel Securitization framework still uses external ratings, as does the new market risk framework being proposed under the Fundamental Review of the Trading Book (FRTB). We believe that this is a further evidences that complete removal of external ratings is both unnecessary and undesirable.

Increased risk sensitivity can produce an improvement only to the extent that risks are accurately measured. Therefore, taking account of the principles and the rationale for the SA review, it would require not only a global framework in which the best performing risk drivers (based on strong empirical evidence) are selected, but comprehensive rooms should be left to local calibration within a clear set of calibration rules. Supervisors should have sufficient leeway to better reflect specificities of the local industries and markets, especially in areas such as the corporate, retail and real estate portfolios.
A specific local calibration for the EU jurisdiction is represented by the SME Supporting factor as in Regulation (EU) No 575/2013, art. 501. It is of outstanding importance that this peculiar measure being recognized (for EU or worldwide) in the new SA. Otherwise an unbearable penalization for standardized banks will take place in EU.

The relevance and the implication of the review call for a time horizon sufficient to collect all relevant data, perform other QIS exercises necessary in order to achieve a meaningful calibration of parameters. Furthermore, a proper phase-in period should be envisaged. The ensuing calibration should be adequate and should take into account also other consultation processes which are underway or in the pipeline both at the BCBS level and at the single jurisdiction level (like in EU the consultations carried out by EBA, and in particular the definition of the past due threshold).

2. Exposure to banks

Risk drivers

We appreciate the fact that the BCBS is seeking to maintain a simple approach by introducing a limited number of risk drivers. However, as mentioned earlier, it is questionable that the use of the proposed risk drivers can lead to more risk sensitivity. First of all reducing the assessment of the risk of bank exposures to just two risk drivers does not seem in line with current risk management practices and may not offer any real advantage versus the use of external ratings. To this end it is worth noting that the process leading to the assigning of an external rating draws on a much larger set of indicators and provides a much more complete picture (rating agencies analysed a large number of indicators to adequately assess risks and are in continuing relationships with the banks). Secondly, it is not on bank exposures that external ratings have shown weaknesses in the past.
Therefore the reliance on external rating for this class of exposures should be preserved, along with the option of using the sovereign method (according to which *"all banks incorporated in a given country will be assigned a risk weight one category less favourable than that assigned to claims on the sovereign of that country"*) **for unrated banks. In the latter case, as a last alternative, appropriate risk drivers and calibrations could be used, provided that they are better defined and tested than the ones proposed in the CD.**

Moreover, a distinct treatment should be recognized in order to take account of (or alternatively discretion should be granted to the national authority for the treatment of) some national specificities, like cooperative characteristics. **These distinct treatment (or discretions) could be substantiated for instance as the recognition of a 0% RW to the deposits that small co-operative banks (generally, indirect participants to payment and settlement systems) are (legally, statutory or contractually) committed to maintain at the level of their central**

institution in connection with the provision of correspondent banking services or to the intra-Institutional Protection Scheme (IPS) exposures.

It is also questionable the underlying ratio for which:

- the lowest risk weight in banking exposures has been raised to 30%;
- the obligor's risk drivers should be those of the legal entity (instead of the whole banking group) against which the exposure is held.

Moreover, we also wonder if applying a 300% RW when any minimum prudential requirement imposed by supervisor (e.g. SREP) are breached is well put. In particular, the question is whether such a treatment would be really justified if a bank showed a LCR of 99% (while it may monetise their liquid assets during stress periods) or if a bank failed to reach a Pillar 2 SREP ratio and third parties are not able to ascertain that such a breach has occurred since the information is not necessarily public. It has also to be taken into account that such rule, and in general the use of the proposed risk drivers, could end up to be quite pro-cyclical and trigger a negative spiral.

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?

Without prejudice to the comments set out in the previous paragraph, we believe that the CET1 ratio is the strongest indicator. Adopting this indicator also ensures neutrality of the proposal for all business models, sizes and complexity, and allow effective comparability, since small banks (especially the co-operative) are *de facto* prevented from issuing AT1 instruments. In this regard we think that further fine tuning and research on the risk drivers for bank exposures is certainly needed, also in the light of the statement (see pag. 7 of CD) that counterintuitive results may unintendedly derive when lower risk weights are assigned to institutions subject to higher capital requirements due to Pillar 2 measures or their global/domestic systemic nature."
The leverage ratio is another useful indicator that also deserves further research. However it would not be neutral for business models such as the central institutions of non-consolidating cooperative banking groups for which the numerous intragroup operations, if not adequately recognised, may lead to a distorted and inaccurate depiction of risk.

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?

We believe that the NPA ratio could be an effective measure in principle. However, from a methodological perspective the proposal poses certain difficulties, particularly to maintain consistency among banks: for example the criteria for recognition of impaired assets may differ country by country due to differences in supervisory approach and accounting. In addition the different riskiness of the exposures which compose the NPA aggregate should be reflected in the determination of the RW, since not all NPA sub-categories have the same level of risk.
Finally, not including the asset quality of trading book in the NPA ratio is not consistent with the aim to have a measure that would be neutral to banks' business models.

Q3. Do respondents have views on the proposed treatment for short-term interbank claims?

We believe that the treatment proposed for short-term interbank claims is unduly penalizing and inadequate. A stronger differentiation is needed between short term and long term interbank exposures, both in terms of definition and calibration.

The proposed floor for short term exposures risk weights of 30% is significantly higher, and hence hardly justifiable, than what the data and experience of institutions have shown. In addition, since the riskiness of short term exposures is more correlated to the counterparty's liquidity than its capital adequacy and the net NPA level we think that the condition that risk weight assigned to non-short term exposures is no greater than 100% should be deleted.
Moreover, the additional requirement that such claims *"are not expected to be rolled over"* would have implications not only on capital requirements, but also on liquidity provisions among banks. In addition there is the issue concerning who is in charge of defining if the claims are expected to be rolled over: if it is the bank, we see a clear conflict of interest for the bank.
Therefore we propose to envisage a unique 20% RW for short-term interbank claims or, in alternative, to retain the current preferential risk weight for short-term interbank claims.
As for the definition we believe that the risk weights for short term bank claims should be based on the residual maturity of the exposures, to provide a more accurate reflection of risk, instead of the original maturity.

Q4. Do respondents have suggestions on how to address these concerns on the treatment of exposures to banks? In particular, do respondents have views on how to treat exposures to banks not subject to Basel III in a consistent and risk-sensitive manner?

Regarding the question of whether it would be appropriate to incorporate country risk as an additional risk driver, while we agree that country risk should be considered (especially where transfer risk is present), it is difficult to imagine how this would be done in the proposed approach. It is also worthwhile to note that country risk, along with other risk factors, is already taken into account in a bank's external rating, making such a rating a simpler and more-informative risk-driver than the proposed ones. **Therefore, we reiterate our view that the use of external ratings of banks should be preserved, along with the option of using the sovereign method for unrated banks. In the latter case, as a last alternative, appropriate risk drivers and calibrations could be used, provided that they are better defined and tested than the ones proposed in the CD.**

3. Exposure to securities firm and other financial institutions

Definition of securities firm and other financial institutions
The definition for securities firm and other financial institutions provided under Annex I, par. 19 of the CD seems too narrow. It would leave a number of institutions out of the scope of this category of exposures (which will be treated as exposures to banks), thus including them among the corporates. In particular, it is not clear if financial institutions which are subject to the main but not 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.

4. Exposure to corporates

Definition of securities firm and other financial institutions

Q5. Do respondents have views on the selection of risk drivers and their 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?
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?
Q7. Do respondents think that the risk sensitivity of the proposal can be further increased without introducing excessive complexity?

We appreciate the fact that the BCBS is seeking a new perspective while trying to maintain a simple approach, however the proposed review brings about numerous elements of concern.
In the first place, as already pointed out for the banking exposures, relying only on two risk drivers does not seem fully proper from the risk analysis point of view, even though at the same time, the use of further risk drivers would greatly increase complexity.
In this regard, we do not see clear benefits stemming from a complete discharge of the external ratings-based approach, which showed good predictive power for corporates. On the other hand, we recognise that there could be a substantial unrated part of corporate exposures. Thus, complementing the external ratings-based approach with some alternatives for the unrated corporates could be a more effective solution.

Audited accounts

The requirement of audited accounts is not applicable in countries like Italy given that only 20,000 firms have an audited balance sheet (this figure become 80,000 to the extent we consider the presence of a board of statutory auditors). On the other side in Italy there are around 1,000,000 incorporated companies which don't have an audited balance sheet every year. Therefore, requiring an *"appropriate verification and due diligence"* when the obligor does not have audited accounts would impose an unbearable burden to standard banks. Finally, also the readiness in the availability of information (depositing times in the Commercial Register and subsequent capture by information providers) poses a relevant issue to be taken into account.
Then, **the requirement of an audited account should be dropped in the final draft or, alternatively, exposures to corporates with non-audited accounts should be treated with a risk weight of 100% and not 300%.** Likewise, **a treatment based on the concept of "investment grade"** (as specified at page 22 of the CD) **could be envisaged for the cases where an obligor has not provided its relevant data, instead of the most penalizing treatment** (*e.g.* in the case of senior corporate exposures, 110% RW instead of 300% RW).

Risk drivers

With regard to the choice of risk drivers, we believe that those identified for corporate exposures (*i.e.* revenue and leverage) are not effective for identifying (cross-sectoral) RWs and are even likely to discourage lending to SMEs, as the assumptions on the drivers may not reflect the actual situation of specific and different industries and the diversification effect of SMEs portfolios has not been taken into account. Numerous other factors usually play a key role in the risk assessment. Such factors, for instance qualitative drivers such as the industry, financial structure, the quality of management, etc., could be considered.
In particular, we have serious doubts about "revenue" as a risk driver mainly for the following reasons:

- we do not believe that the size of the company, as a purely quantitative criterion, should have such a weight as it is not necessarily reflective of risk;

- SME exposures, on a loan-by-loan basis, have on average an higher default rates but at portfolio level they show lower asset value correlation which could mean lower unexpected loss level (this behaviour is mirrored by the preferential treatment extended to SMEs under the IRB approach);
- generally, exposures to smaller corporates are highly collateralized relative to exposures to large corporates (by guarantees and non-financial collateral types that do not qualify for being recognized as a credit risk mitigation technique).

Moreover, the proposed approach seems also to overlook the fact that the relationship between default rates and size of a corporate could be strongly country specific; as such it cannot be specified as a global rule. As an example we can quote the case of Italy where, according to an analysis performed by CRIF (the leading provider of banking credit information in Italy), businesses with revenues between €5 and €50 million show a default rate behaviour similar to larger corporates, which does not justify the higher risk weights proposed.

Also the use of leverage as a risk driver is a problematic choice, because of this driver being highly industry or business specific (*e.g.* trade vs. production). It may also depend on jurisdictional considerations (*i.e.* legal framework regarding tax shielding and collateral repossession, close out and bankruptcy costs, etc.). In addition, the level of leverage does not necessarily reflect the risk of a company. As mentioned above, most exposures to smaller corporates are highly collateralized relative to exposures to large corporates and risk mitigating factors (e.g. guarantees and other collateral) should be better reflected. Leverage is also problematic when dealing with partnerships or non-incorporated companies. In such companies there is only a fiscal/virtual separation of the company and the patrimony of the owner. The owner's patrimony remains available as collateral for the bank, even though it may not appear on the balance sheet of the company. Thus in these partnerships and non-incorporated companies, differently from companies with legal personality, the liability of the entrepreneur is not limited to the own funds actually poured in the company. This may also explain why many of the smaller companies, many being non-incorporated, show lower capital ratios.
The incorporation of off-balance sheet exposures can for sure increase the risk sensitiveness but at expense of greater complexity.
Moreover, there are sectors where both "revenues" and "leverage" are not meaningful at all. The so called "Confidi", *i.e.* mutual credit guarantee consortia, are active in Italy, France, Spain and other European countries. If treated as corporates - as it seems to be the case given that also for supervised Confidi it is difficult to argue that they are subject to a level of supervision equivalent to that applied to banks (including capital and liquidity requirements) - they would surely be penalized by the proposed RWs and they would lose their capability of enhancing SMEs access to bank credit. That of course is not the only industry to suffer from the use of such indicators. For example, the "revenue" risk driver would be difficult to be applied to investment funds, which are independent entity, fully separated from the investment firm which manage them. The aim of this entity is to collect funds form savers and administrate them and the result of this activity is reflected mainly in the net asset value (NAV) of the fund and not in the *"income the company [receives] from business activities as determined by the accounting standards of the relevant jurisdiction"*.

The treatment of SMEs
The assigned risk weights for corporate exposures appear to be quite punitive. We observe, for example, that the risk weight for highly-rated corporates (AA or higher rating) will triple (from 20% to 60%), while non-rated, smaller businesses will be weighted not below 100% and up to 130%. This will definitely bring to an increase of the capital requirements. Overall, it seems that the proposed treatment would entail important potential disadvantages for SMEs and banks with large SMEs' portfolios which would not be justified by the loss experience of last decades and is difficult to justify from a political perspective. In fact, this is even more relevant in jurisdictions

such as the EU, where SMEs are the economy's backbone (99% of businesses, 66% jobs[1]), and where such proposals may be difficult to be properly communicated as they have relevant policy implication. Bank-related products are still the most relevant sources of finance for euro area SMEs, and cooperative banks have been a steady anchor of financing for the real economy also during the most critical moment of the financial crisis. Therefore, the proposal raises concerns for the likely disproportionate negative impact on own funds of credit institutions, such as cooperative banks, with a tradition of and a focus on SME lending. The Italian Co-operative Credit Banks have a long standing practice of SME lending and a large proportion of their credit portfolios are made up of companies with very low level of revenues. These proportions may even increase due to the granularity criterion proposed for retail exposures. Indeed numerous exposures, especially for smaller institutions which have small aggregated retail portfolios, would migrate from the retail to the corporate category with serious cliff-effect consequences. Empirical evidence should be produced that shows such RWs is warranted on the basis of past credit history of this asset class. In this regard, we also have doubts on the preliminary assessment underpinning the proposal that SME exposures are generally riskier than exposures to large corporates. In fact, there are at least two elements to be taken into account: first, the data collected may not be relevant across all jurisdictions, and second the preliminary exercise does not seem to take into account the experience of other institutions, acting locally and with better experience and knowledge on SME loans. Furthermore, under the IRB approach, SMEs get a benefit on a single counterparty basis compared to large corporates, in order to take into account the diversification effect. A similar approach would be expected for the SA. Also, the argument expressed under point 1 at page 11 of the consultation paper, seem more to reflect the aggregated credit quality of the portfolio observed rather specifying the inherent expected riskiness of SMEs vs large corporates. **Consideration could be given to capturing SMEs exposures in a dedicated and appropriately calibrated subcategory** (see below).
Furthermore, it seems that the proposed risk drivers may induce procyclicality, also considering that the proposed buckets and the levels of RWs may give way to significant 'cliff effects' for corporates at the border between buckets.

Global standards and local calibration
In a nutshell we think that "revenues" and "leverage" are not very effective instruments of risk measurement. Since the relationship between them and the risk of the corporate exposures could be country specific and depend on several other factors (e.g. industry type and type of lending) we believe they should be removed from a global rule. Considering the relevant drawbacks posed by the new proposal **we ask for leaving the standardised corporate methodology unchanged and only slightly recalibrated. By the way, when considering the whole regulatory, picture we believe that an increase in capital requirements will take place anyway in the near future due to other changes in the regulative framework. Otherwise, global standards with local calibrations and differentiation by macro-economic sector/type of business (industrial production vs multi-year production, vs retailers) could be an option to increase the risk sensitivity of the SA approach without adding excessive complexity. A specific local calibration for the EU jurisdiction is represented by the SME Supporting factor as in Regulation (EU) No 575/2013, art. 501. It is of outstanding importance that this peculiar measure will be recognized (for EU or worldwide) in the new SA. Otherwise an unbearable penalisation for standardised banks will take place in EU.**

Recognizing non-financial collaterals
While the credit risk SA since Basel I has not recognized physical collateral (except real estate) for regulatory capital purposes due to the emphasis on simplicity, the new credit risk SA proposals aims to reflect a reasonable extent of riskiness of exposures (objective (*ii*) under

[1] European Commission (2014).

Section 1.1) and increase comparability of capital requirements under SA and IRB (objective (*iii*)). **The proposed new SA could achieve both objectives without resulting in undue complexity by recognizing credit risk mitigation to corporate exposures secured by guarantees and non-financial collateral types that do not qualify as specialized lending** (e.g. transportation, industrial, or office equipment that are secondary to the servicing of the loan) and yet substantially increase prospects of recovery in case of default.

Recognizing specific treatment to factoring

We also believe that factoring deserves a specific approach due to its peculiarities. In Italy the estimates of the LGD in factoring are lower than 15% while the SA assumes a flat LGD of 45%. For this reason, we suggest:

- in the view of the alignment to the IRB approach, to provide also in the SA the possibility to weight the exposure with the risk of the assigned debtor instead of the RW of the client even in recourse operations;
- to provide a lower, specific RW for factoring exposures, by way of a cap on the RW (*i.e.* all exposures to factoring can be weighted up to 75% instead of the RW indicated by the above mentioned approach) or of a cutoff of the RW emerging from the table (*i.e.* all RWs for exposures to factoring are reduced by, for instance, 25%).

The treatment of start-up companies

While we see a merit in providing a dedicated treatment to start-up companies, the 110% risk weight seems inappropriately high. In addition, it is unlikely that a start-up could achieve within one year a satisfactory level of leverage or profitability. **A preferential treatment with a lower risk weight is justified for such companies and should be applied to all start-up companies, including non-incorporated companies.**

Exposures to corporate with negative equity

Finally, we think that the proposal of a 300% RW for corporate exposures toward counterparties with negative equity would be unduly penalizing for the Italian market where the SME are usually high collateralized but with high leverage ratios. As already said, in this form of company the line between the assets of the individual and those of the companies may be in the discretion of the entrepreneur and depend on multiple factors. There might be very good reasons for the entrepreneur not to have very much capital in his company and even to have negative own funds. Overall, the negative own funds does not necessarily mean insolvency.

Q8. Do respondents agree that introducing the specialised lending category enhances the risk sensitivity of the standardised approach and its alignment with IRB?

We have strong doubts on the statement of the CD that specialised lending generally exhibits higher risk and losses than other types of corporate lending. Indeed, the proposed RWs applicable to specialised lending (SL), with a floor at 120% or 150%, is extremely penalizing and totally disregards the multiple safeguards and covenants associated with these transactions. We think such supposition does not hold true at least for relevant parts of the specialised lending asset class like Income Producing Real Estate (IPRE).

Eventually the application of the proposed RWs may increase distortions between the regulated banking sector and non-regulated shadow banking/investors, posing a real problem of level playing field and a threat to financial stability.

It could force banks to finance projects and assets on a corporate base (unsecured) rather than SL base in order to reduce the costs in terms of capital. This will eventually increase the credit risk and could encourage investing in higher yielding projects which by nature are more risky.

There is also a strong need for more granularity for the various forms of SL (Project finance, Commodity Finance, etc.). This could be done through:

- determining specific risk weights by subcategory, e.g. taking into account structure/collateral specific elements (for example: if more than 100% commodity collateral);
- recognition of non-financial collateral through the Credit Risk Mitigation framework (e.g.: liquid and exchange-tradable (hence objective valuation) commodities could be recognized in a similar way as gold);
- define specific lower floors, when structure/collateral is present.

We propose that the final risk weight is calibrated against factual experience and records on these activities. For that purpose, we would like to remind of the fact that typical corporate lending is unsecured whereas specialised lending is secured by valuable assets and cash flows.
A specific focus deserves the new definition of development real estate assets. As a matter of fact, the new definition of real estate exposure is *"fully completed"*. The development real estate assets would be classified in the "SL portfolio" with a relevant penalization for this kind of market which is really important for the GDP of the most part of European countries.

4. Subordinated debt, equity and other capital instruments

We believe that a distinct treatment should be recognized in order to take account of (or alternatively discretion should be granted to the national authority for the treatment of) some national features which could be relevant for prudential regulation, like cooperative characteristics. **These distinct treatment (or discretions) could be substantiated for instance as the recognition of a 100% RW to the regulatory capital instruments (CET1, T1 and T2 instruments) issued by a bank which are member of the same cooperative banking groups or IPS. In particular, a 100% RW should be recognized to the regulatory capital instruments issued by the central institutions of the same cooperative banking groups or IPS**, by virtue of the primary role that they perform as wholesale products and services providers for local co-operative banks and an intra-network inter-bank markets.

5. Retail portfolio

Orientation criterion

The CD only refers to exposures to "small business", without giving any more detail. However, since the overall exposure to such companies may reach a threshold of €1 million, it can be concluded that a "small business" may reach a certain relevant size. **We suggest to include not only small, but also medium-sized businesses in that scope and to set a limit for SMEs like in the EU legislation, taking into account only the annual turnover (not higher than €50 million) among the three criteria.**
Exposures to SMEs where personal guarantees are given should qualify as part of the regulatory retail portfolio.

Granularity criterion

The BCBS rightly considers the diversification criterion to be one of the primary justifications for the current preferential treatment. However, enforcing this criterion as a binding quantitative granularity criterion (set at 0,2% of the overall regulatory retail portfolio) is not the right way to pursue the objectives of the proposed revisions of the SA.
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.
Moreover, the interference of both the corporate risk drivers and the strict retail criterion could lead to very important cliff effects: once an exposure to a small company falls out of the retail portfolio with 75% risk weight, it may qualify for a 130% risk weight as a corporate exposure: due to the fact that the leverage of the smallest companies tends to be rather low, such effects would probably be very frequent.
This can entail significant drawbacks; in particular the specific business model of small banks – informally-intensive and 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 SMEs-borrower would be weakened and in turn the pursuing of the typical benefits of the relationship lending would be jeopardized. Therefore, 'multiple banking relationships' might result in a degeneration of the basic management criteria of diversification.

Eliminating any national discretion for the granularity criterion is not useful and does not strike the right balance among the objectives of the (*i*) level playing field, (*ii*) financial stability and (*iii*) bio-diversity of financial and non-financial sectors.
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 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 raise pressure on supervisors and policy makers to ensure that local economy is unharmed by imposing relatively too strict thresholds.
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.
Additionally or alternatively, in light the of the above considerations, a proportional approach could be envisaged for credit institutions with a retail portfolio (without taking account of granularity criterion) below a certain threshold (e.g. €500 million (0.2%=1/500)) to be subject only to the loan size criterion removing 0.2% granularity criteria.
We agree with the indication of footnote 53 that no circular calculation has to be made and that granularity criterion is to be verified only once.

Loan size criterion
As for the threshold value of individual exposures, we believe that it should be raised to €1,5 million (this level was determined at least 12 years ago) and adjusted to inflation on a regular basis.

Impureness rate
Furthermore, **we believe that a certain 'impureness rate' of the retail portfolio should be allowed, which could provide to include smaller exposures to corporates into the retail portfolio** (*e.g.* up to a maximum of 10% of the portfolio). In fact, particularly in the case of very small exposures to corporate entities, the suggested treatment for corporate exposures, which requires a steady evaluation of balance sheets seems disproportionate.

'Cliff effect' resulting from SMEs migrating from regulatory retail portfolio to the corporate portfolio

Where a simplified approach has been developed for smaller and less complex institutions any 'cliff effects' should be avoided in order to prevent such simplified solutions from becoming a disproportionate burden for these institutions. This can be the case of the migration of a SME exposure from the regulatory retail portfolio to the corporate portfolio.

In order to prevent a significant cliff effect **we believe that the current treatment to non-retail small business exposures should be maintained. In alternative, a 100% risk weight should continue to be applied in the following cases:**

- **sole proprietorship or self-employed or micro-small business entities that do not meet the criteria to be considered as retail exposures;**
- **SMEs that do not meet simply the loan size criterion.**

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?

The preferential treatment of 75% right weight is fully justified. Therefore we do not see any reason to increase it or use other risk drivers to differentiate the risk of retail exposures which can result in an increasing of the risk weight.

On the other hand, **the "established relationship" might play an important role especially if it is a relationship lending type** (*e.g.* in taking influence on the behaviour of the counterparts in order to prevent and manage their crisis). Therefore, further and deepened analyses should be carried out in order to ascertain if it can be considered as a risk driver (or in combination with others) to better differentiate the risk of retail exposures and hence to apply a risk weight lower than 75% to exposures whit such characteristics.

In addition, the CD suggests that the respondents provide evidence on specific products that have different risk characteristics, compared to the other retail exposures. About this aspect, we propose a specific supervisory treatment for Salary Secured Loans and Pension Secured Loans (Cessione del quinto dello stipendio, SSLPSL) and retail leasing exposures.

SSLPSL represent a particular technical form of consumer credit which is supported by a series of guarantees that reduce the credit risk in comparison with other forms of retail loans. SSLPSL clearly have numerous characteristics that mitigate risk: accordingly, a favourable prudential treatment (risk weight lower than 75%) should be applied.

In Italy SSLPSL are ruled by the law and by secondary regulation. This kind of consumer credit is supported by a series of guarantees that reduce the credit risk in comparison with other forms of retail loans. Namely, these guarantees are:

- direct assignment of one-fifth of the pension or salary to cover payment of the loan instalments;
- 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);
- transfer of the effects of the assignment of salary to the pension when the borrower retires;
- restrictions on availability of retirement bonus (so called Trattamento di Fine rapporto – TFR) and/or similar indemnities, with immediate recourse available to the creditor;
- restrictions on possible attachments and seizures of the salary/pension that guarantee the privileges of the lender in comparison with other creditors.

SSLPSL clearly have numerous characteristics that mitigate risk: accordingly, favourable prudential treatment should be applied with respect to alternative forms of consumer credit. The evidence of a low level of credit risk is supported by the outcome of a sample survey carried out by the Italian Banking Association (ABI) 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%;
- the expected loss (EL) is 0.16%.

Accordingly, the theoretical RW factor, calculated on the retail curve, is 8.4% (compared with the regulatory parameter using the current standard method of 75%). In view of this evidence, it is requested that SSLPSL be recognised as loans less riskier than the retail portfolio loans and deserve a RW really lower than the current RW for retail portfolio (75%).

As for retail leasing exposures we notice that most of the equipment and automotive leasing exposures have the characteristics to be included into the retail portfolio. Leasing companies can be specialised in specific sectors and asset industries and, in those cases, the proposed granularity requirement (0.2%) might be not fulfilled. Nevertheless, retail leasing exposures deserve a 75% risk weighting because they should be included into the category of *"loans secured by durable goods"* [see CD, par. 2.4.1, ii) Treatment, point (i)]. In leasing contract the guarantee represented by the leased asset is even stronger as the lessor maintains the 'ownership' of the asset for the whole duration of the contract. Asset ownership represents a major advantage for lessors compared to other financial products. This is demonstrated by the results of a recent research conducted by Deloitte on behalf of the European Leasing Federation (Leaseurope). In the Deloitte's Report: *"The Risk Profile of Leasing in Europe: The role of the leased asset"*, it is showed that default and loss rates for leases are significantly lower than for traditional lending. According to this 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. The automotive leasing sector could also deserve a better treatment. The Italian data about automotive leasing shows lower percentage of defaulted contracts in the portfolio and higher recovery rates.

A specific local calibration for the EU jurisdiction is represented by the SME Supporting factor as in Regulation (EU) No 575/2013, art. 501. It is of outstanding importance that this peculiar measure will be allowed (for EU or worldwide) in the new SA. Otherwise an unbearable penalization for standardized banks will take place in EU.

6. Exposures secured by residential real estate

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?
Q11. Do respondents have views about the measurement of the LTV and DSC ratios? (In particular, as regards 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.)
Q12. Do 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?
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?

We do not see any reasons for the modification of the RWs for these exposures. In the EU there has been no evidence of risk capture problems with the current SA for credit risk. Were there the need for regulatory action, competent authorities in the EU are already entitled to set higher RWs based on the loss experience and forward looking market developments of exposures secured by immovable property. Thus, in particular for the EU, these changes are unnecessary. The proposed 'one-size-fits-all approach', while trying to result in increased sensitivity, reveals certain limits that may lead to unintended consequences especially for residential real estate markets strongly characterized by several domestic specificities. In particular, the approach does not take into consideration any insurances against the repayment of the loan.

The envisaged treatment is strongly penalising for the development of European mortgage and real estate markets. It will have also a significant negative impact on the consumers' capability to purchase residential real estate. Maintaining a DSC not higher than 35%, in order to apply the current RW, banks will be forced to grant mortgage loans with a LTV lower than about 50%. It means consumers will have to bear at least 50% of the house market value with own funds. The adverse consequences of this proposal could be:

- a remarkable restrictions to access the homeownership market for 'low/middle income' consumers, with a further negative impact on the European real estate market;
- a disincentive for lenders to grant (particularly high LTV) mortgage loans with a general increase of residential mortgage interest rates affecting borrowers and indirectly also their creditworthiness, in terms of sustainability of payment of instalments.

The proposed revision doesn't seem to be supported by specific data on the residential mortgage exposures risk sensitivity on the basis of the LTV. In fact, according to data[2] collected by CRIF the level of credit risk increase significantly after a level of LTV of 80%.
Furthermore, if residential real estate exposures also benefit of additional collateral/guarantee, recognised under credit risk SA, this should be reflected in a lower risk weight (*e.g.* risk weight of the guarantor could be used instead of the risk weight of the borrower). This is relevant because often banks only grant higher LTV loans where such collateral exists (*e.g.* mortgage insurance, unemployment insurance, parent guarantees, sovereign guarantees, financial collateral) and which allow them to reduce the LGD. In particular, supporting data also show that mortgage insurance not only reduces/mitigates credit losses in the event of a default but also reduces the risk of default itself, across the LTV spectrum. Because of this the mortgage insurance should be explicitly recognized as a credit risk mitigant.
The use of LTV at origination (only) is not in line with good risk management, and their use to label a loan at origination as high risk for its lifetime is counter-intuitive. Moreover, it may have a multitude of negative, counterproductive effects. In particular, it could discourage longer-term lending relationships creating incentives for lenders to switch to other banks or to cancel and originate a new loan with the current bank in order to draw advantage from a better LTV after some years, when the outstanding debt is reduced due to repayments and when the value of the property has increased. Vice versa, a point of great concern is the monitoring of DSC during the mortgage loan life. It would be very burdensome and could be difficult in some European legislations to collect this information because of privacy issues. The DSC level should be assessed only in the moment of creditworthy analysis. Moreover, DSC there is no common definition of DSC and formulating a workable one across countries seems really unimaginable.

Therefore, in the light of the above comments, **we propose to retain the current treatment (*i.e.* 35% RW) for exposures secured by residential real estate with a LTV not higher than 80% and provided that DSC is lower than 35/40%.**

[2] Data related to a sample of loans granted in Italy from 2009 and 2011 and in default status in October 2013.

In paragraph 40, the value of the loan is the one "measured at origination" but then the proposed regulation states "unless an extraordinary, idiosyncratic event occurs resulting in a permanent reduction of the property value. Modifications made to the property that unequivocally increase its value could also be considered in the LTV." It implies that the bank set up a monitoring system of the real estate collateral to detect this events. Without prejudice to the comments set out above on the updating of the LTV, it could be beneficial to define more specifically what type of events are considered "extraordinary and idiosyncratic" (e.g. fire, floods and other risks normally covered by specific insurance policies are to be considered extraordinary and idiosyncratic or not)

With reference to destination of use of the considered real estate, the mortgage loans to buyers of "first houses" (i.e. main residence) show an expected loss lower than other kind of exposures. As a matter of fact, these specific householders have all interest to pay their instalments to avoid to lose their "own" (and often "only") house, without considering the value of property compared to the mortgage loan.

The requirement for qualification as residential real estate exposures to be a "finished" property (i.e. concluded) cannot apply to self-builds. Self-built residential properties are instead even specifically regulated in certain legislations (e.g. triggering tranche payment only on completion of a specific building phase) and should be adequately addressed.

The proposed treatment would also entail enormous impacts in applying the new RW to existing loans, for a number of reasons:

- prompt re-pricing is legally not possible; this would have a direct impact on issuing capital and/or reducing assets (*e.g.* also by means of securitisation);
- it would have severe and punitive effects on a high quality portfolio (long term based);
- key data under the new proposal, such as DSC would not have been captured and retrospective application would create undue burden on all banks, and in particular smaller credit institutions whose assets are generally tilted toward residential mortgage.

A prudent way forward would at least allow banks to apply the new rules to new loans from an agreed cut-off date and leave the back book at 35%.

7. Exposures secured by commercial real estate

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?
Q15. What other options might prudently increase the risk sensitivity of the commercial real estate treatment without unduly increasing complexity?

We believe that the proposals for commercial real estate exposures are strongly influenced by the bad experiences recorded in certain countries in recent years, although other jurisdictions have not undergone the same difficulties. Thus the approaches envisaged do not reflect adequately markets characteristics and are overall too conservative with regard to loss rates experienced with exposures secured by commercial real estate.
Moreover, it is not clear what the CD means by "commercial real estate" (for instance if in this portfolio are included hotel, industrial platforms, firms, offices, shops etc.). With this regard, we propose to define this kind of portfolio as *"non residential real estate exposure"* as EBA has already established (see EBA's Single Rulebook Q&A 2014_1214). The indirectly imposed finished property requirement may be counterproductive as real estate being a non-essential business asset often is vacant while serving best for credit risk management purposes.

In general, we appreciate the flexibility provided under the proposed option A, although some of the criteria described in footnote 59 of the CD to allow a preferential treatment may still be too strict. With regard to option B, we see that it is overall not sufficiently flexible.
About the RW, both the options proposed penalize current RW which is 50% for LTV < 60%. The first proposal allow to maintain the same RW of current treatment only if stricter requirements are fulfilled and subjected to national discretion. The second one increases of 50% the current RW. Both proposals reduce the importance of this collateral which is used especially to collateralized SME exposures. Combining those proposals with new "definition of default" will help to create credit crunch phenomena. Furthermore, there is no data justifying this kind of penalisation.
We propose to maintain the current treatment and in case increase the RW for exposures with a LTV higher than 60% (*i.e.* the current threshold).

Recognizing specific treatment to real estate leasing
With regard to real estate leasing, it is worth noticing that it differs from mortgages because the lessor maintains the "ownership" of the asset for the whole duration of the contract. The full ownership of the leased real estate allows the leasing company to finance the entire value/cost of the asset and grants a quicker recovery/repossession of the asset in case of default of the contract. The new approaches for real estate exposure proposed in the CD being based on the LTV ratio do not fit to real estate leasing market which represents an important source of finance for business real estate investment (especially for SMEs) in some important European countries (*e.g.* Italy, France, Austria, Spain). The ability of the lessor to correctly evaluate the real estate asset financed should be part of the weighting mechanism. Namely, in addition to require higher RWs for higher LTV ratio, it should be introduced a mechanism that, notwithstanding the initial LTV ratio level, would reward the lessor when the asset does not depreciate during the contract life and allow him to apply a 50% RW when the LTV ratio becomes lower than 60% (or 50% if referred to the market value, as specified in footnote 60 of the CD). For commercial real estate leasing, we propose to consider the possibility to adopt a third option: at the beginning of the contract, when real estate leasing LTV is higher than 75%, the exposure is 120% weighted; when LTV ratio decreases falling below 75% while still above 60%, the leasing real estate exposure will be weighted at 100%; than when LTV lower than 60% (or 50% if referred to the market value, as specified in note 60) the current treatment or option A along with footnote 59 could be applied with a 50% risk weighting of the real estate exposure.

8. Risk weight add-on for exposures with currency mismatch

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?

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9. Off-balance sheet exposures

Q17. Do respondents consider the categories for which a CCF is applied under the standardised approach to be adequately defined?
Q18. Do respondents agree that instruments allocated to each of the CCF categories share a similar probability of being drawn and that the probabilities implied by the CCFs are accurate? Please provide empirical support for your response.

Commitments that are unconditionally cancellable at any time without prior notice should continue to be treated with a 0% RW, provided that terms & conditions in the facility agreement and the internal procedures allows to unconditionally cancel the lines in case of worsening of the credit worthiness of the debtor.
We disagree with the choice of not marking a difference between commitments with different maturities (currently with 20% and 50% CCF, depending on the maturity, but now proposed to receive a uniform CCF of 75%) as this approach will not be risk sensitive and does not add to the comparability of RWAs with IRB banks (as the one year maturity floor may be lifted for some trade products). It will also provide wrong incentives for banks to grant commitments for longer periods, and it is not consistent with banks' internal historical drawdown rates.
The aim of the review would be to align the credit risk SA and FIRB, but no reason is given as to why the 75% CCF under FIRB is more appropriate that the existing credit risk SA CCFs of 20% and 50%. A clarification on the underlying rationale would be welcomed (*e.g.* any quantitative analysis justifying the higher CCFs).

10. Past-due loans

Q19. What are respondents' views on the alternative treatments currently envisaged for past-due loans?

In general, the classification of past due exposures should remain as simple as possible. we are not in favour of an approach which sets an add-on to the applicable RW which varies as a function of the amount of provisions. Finally consistency between SA and IRB is also important with respect to the defaulted assets.

11. Exposures to multilateral development banks

Q20. Do respondents agree with the proposed treatment for MDBs?

We believe it is important that government backed MDBs maintain a 0% RW. Furthermore, considering the limited number of MDBs instead of defining a mix of quantitative and qualitative criteria it would be more effective to assign by the Committee the specific risk weight to each of them, by applying in a centralized and uniform way the criteria defined.

12. Other assets

Q21. What exposures would be classified under "Other assets"? Is a 100% risk weight appropriate? (Please provide evidence where possible).

The approach should allow banks to perform the most pragmatic and simple determination of "other assets". The current exemptions to the 100% RW should be upheld. In addition, it seems consistent to include under the SA only those items which imply a counterparty risk.

13. Eligible financial collateral

Q22. What are respondents' views on the above alternative ways to define eligible financial collateral?

The alternative way proposed to define eligible collateral is understandable in its objective but bring the *caveat* that it is based on rather qualitative assessment; therefore, it could lead to different risk assessment among banks for the same collateral and /or conflict of interest for the banks in assessing the eligibility.

Q23. What are respondents' views on the recalibrated supervisory haircuts shown in Table 4? 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?

The haircuts for High Quality Securitizations (HQS) are too high. HQS should receive a preferential treatment.

14. Eligible credit protection providers

Q24. What are respondents' views on the proposed corporate guarantor eligibility criteria?

The SA framework is focused on the borrowers' characteristics, while many bank business models are based on a strong structuring (collateral, control, etc.). Not including non-financial collateral types that currently do not qualify for being recognized as a credit risk mitigation technique is therefore bound to lead to wrong incentives as risk sensitivity would be lost, especially with regard to SME exposures and within high-quality portfolios.
Moreover, in the current framework, only the life insurance policies are recognised as eligible collaterals, provided that specific requirements are met. We propose to include all kind of insurance policies issued by insurance company even if they are issued by unrated insurance companies. As a matter of fact, what it is important is that the insurance company are authorized and supervised by public supervisor authorities.
This would also contribute to a better comparability of RWAs among SA banks and between SA banks and AIRB banks, without the burden for SA banks to develop costly internal models.

15. Treatment of repo and OTC derivative transactions
We do not see any reasons for the modification of the RWs for these exposures.