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Revisions to the Standardized Approach for Credit Risk (BCBS n° 307)

As the Basel Committee on Banking Supervision asked for it, you will find attached a few comments I have on the probably unintended negative consequences of some proposals on the financing of International Trade.

In October 2011, the Basel Committee recognized the importance of Trade Finance, especially for low-income countries and made some decisions to support Trade Finance with these countries (cf BCBS 205). Taking into consideration the reports published on a yearly basis by ICC on the low risks related to Export Finance and Trade Finance and the importance of these financings for exporters and importers, we need to prevent unintended consequences of the proposals of BCBS 307.

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

As of today, short-term interbank claims related to Trade Finance are mostly off-balance sheet commitments. For these off-balance sheet commitments linked to Trade Finance activities, it would be important to maintain the prevailing CCF:

- 20% for short-term (up to 90 days) self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralized by the underlying shipment), applying on confirming and opening banks (cf Point 85 of BCBS 128)

The proposed reduction by 20% would mean a factor of 280% instead of 300% for a bank which does not publish data according to Basel III. The factor would hence be multiplied by 14 for confirmations of short-term LCs on most banks in emerging countries...

The same 20% factor should also be maintained for banks which take a Corporate risk by opening such LCs (cf Q 17).

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?

According to the Table included in Point 13 of Annex 1, banks which do not apply Basel III and will hence publish data on CET 1 ratio and NPA ratio which will not comply with Basel III requirements will be penalized by a 300% factor; while as of today the maximum factor was 150% (Point 8 of Annex 11 of BCBS 128). This penalization doees not reflect the risks linked to Trade Finance and will harm low-income countries. The prevailing situations based on ratings (and if need be on the rating of the country where the bank is established) better fit with the reality of Trade and Export Finance activities.

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?

A system based on rating is efficient as it values non-financial criteria which are part of the credit analysis. The suggested methodology which is only based on figures (firstly turn-over and secondly leverage) will not take into account qualitative criteria. Industrial companies will be penalized.

Loans granted by MDBs are also at stake. In its footnote 37 of BCBS 128, the BCBS recognized the value of the presence of a MDB as banks were allowed to consider the local rating instead of the foreign currency rating of a corporate when they participated in a loan extended by an MDB. If ratings are not considered anymore, the value of the presence of an MDB cannot be taken into account and co-financings with MDBs will be affected.

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?
Criteria which are firstly based on turnover will affect primarily SMEs which have limited turn-overs... And start-up companies would be better dealt than long-term established and performing SMEs... The former system based on ratings is probably more appropriate.

Q17. Do respondents consider the categories for which a CCF is applied under the standardised approach to be adequately defined?
For Trade Finance assets, such as Letters of Credit and Technical Bonds, the proposed 75% factor is unduly penalizing a low-risk activity. The existing factors should be kept :

- 20% for off-balance Trade Finance sheet items (such as technical guarantees, other letters of credits,...) with a maturity below one year
- 50% for off-balance sheet Trade Finance items (such as technical guarantees, other letters of credits,...) with a maturity above one year (cf Point 25 of Annex 11 of BCBS 128)

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.
In Trade Finance, uncommitted lines have almost no probability of being drawn. A 10% CCF (instead of 0%) for uncommitted lines related to Trade Finance does not reflect the reality of this business.

Q20. Do respondents agree with the proposed treatment for MDBs?
It is crucial to maintain a 0% risk weighting of highly rated MDBs, which support efficiently some Trade Finance operations through their Trade Finance Facilitation Programs.
As mentioned on Q5, the advantage delivered by their presence when they lead a co-financing has to be also recognized.

Q24. What are respondents' views on the proposed corporate guarantor eligibility criteria?
For Export Finance, the value of the cover granted by an ECA (officially supported Export Credit Agency participating in the Arrangement on Officially Supported Export Credits promoted by the OECD), under has been recognized since Basel I, whatever their status (governmental agencies, public companies, private companies).. The QIS 3 FAQ published in December 2002 (Credit Risk Mitigation - Point 6) made no difference between guarantees and insurances. As long these covers meet with the criteria of a guarantee as described in points 125,126, 127 and 128 of Annex 1, it will be important to maintain the possibility to use, in the absence of any external rating :

- For the part covered by the ECA (usually 95% to 100%), the prevailing risk-weighting based on the rating of the Sovereign of the ECA whatever the legal status of this ECA, using if need be the rating grid provided by the Arrangement of the OECD (cf Point 55 of BCBS 128)
- For the uncovered part, if any, the prevailing risk-weighting based on the rating of the borrower as rated by the ECA or the OECD

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During my 28 years in the banking world (with Credit Lyonnais and Credit Agricole), I hold several positions in Export Finance, Trade Finance and Project Finance. As Global Head of Export Finance for Credit Agricole, I chaired from 2008 until 2013 the Export Credit Group of the European Banking Federation. Over the last two years, with HDA Conseil, I have been involved in several projects with the Banking Commission of the International Chamber of Commerce, the European Investment Bank and Bpifrance as well as with Export Credit Agencies.