HELLENIC BANK ASSOCIATION

Response from the Hellenic Bank Association to the Basel Committee on Banking Supervision consultative document: *Revisions to the standardised approach for credit risk*

General comments

The Hellenic Bank Association (HBA) was established in 1928 and is a non-profit legal entity, representing the vast majority of Greek and foreign credit institutions that operate in Greece, which hold more than 95% of assets of the Greek banking system.

The HBA appreciates the opportunity to respond to the Basel Committee on Banking Supervision (BCBS) consultative paper on *revisions to the standardised approach for credit risk*, which is issued in the context of the BCBS initiative to revise the standardised approaches for measuring risks in order to ensure that capital requirements reflect the inherent riskiness of banks' exposures.

In general, we fully support the BCBS aims of reducing reliance on external credit ratings, increasing risk sensitivity and enhancing comparability of capital requirements across jurisdictions. However, some of the proposed changes do not contribute to the fulfillment of the abovementioned objectives. More specifically, assigning risk-weights under certain risk drivers, though improves risk sensitivity, leads to increased complexity, particularly for smaller -less sophisticated- banks, and causes significant distortions in the level-playing field across jurisdictions.

The consultative document lays down major amendments to the current regulatory framework, which is expected to have substantial consequences not only to banks using standardised approach for credit risk, but also to IRB banks, because of their obligation to comply with provisions concerning capital floors. We consider that the revised framework for the standardised approach, though not intended, will lead to significant increase of the capital requirements, particularly for banks using the standardised approach.

With regard to the implementation arrangements, the HBA supports the willingness of the BCBS to provide sufficient time for implementation of the new provisions allowing to less sophisticated banks to adjust their IT systems and risk models to the newly-established approach.

Specific comments by asset class

I. Exposures to banks

Mechanistic reliance by banks on external ratings is recognised as one of the roots of the financial crisis, though the introduction of arrangements eliminating the use of external ratings for the purposes of measuring credit risk is undue and is likely to lead to adverse implications. Given that external ratings are derived from a great range of useful information regarding banks' exposures to risks, it is plausible to assume that in most cases reflect in a better and in a more representative way the credit quality of exposures.

Enhanced due diligence and effective risk management are prerequisites for ensuring banks' financial strength. Use of external ratings for the purposes of measuring credit risk by no means relieves banks from the obligation to assess the credit quality of exposures and their inherent riskiness. Therefore, we propose to sustain the external ratings as a measure to risk weight exposures to banks, as well to corporates, where available.

If a capital adequacy risk indicator is to be adopted, we would like to stress that leverage ratio is not the most suitable. Leverage ratio has a dual mandate: to act as a backstop measure that offers a safeguard against the likely weaknesses in banks' ability to model risks and, for macroprudential purposes, to limit the risk of excessive leverage by constraining the building up of leverage in the banking sector during economic upswings. Furthermore, is widely known the problem concerning the differences in the calculation of leverage ratio among jurisdictions, which is likely to hamper BCBS goal to enhance comparability across banks and to ensure a level playing field.

Consequently, leverage ratio cannot be considered as a good predictive risk indicator and in our view should not be adopted as a measure of capital adequacy. Instead, in cases where credit ratings are not available, we support the use of risk-based regulatory capital ratio as a risk measure.

With regard to the other proposed risk indicator, the HBA is not in favour of adopting the ***Non-Performing Assets*** ratio (NPA) as a risk driver, since this ratio alone is not representative of the bank's portfolio riskiness. Assigning risk-weights to exposures to banks based on their NPA ratio would make sense, only if it encompasses the value of collateral.

II. Exposures to corporates

The proposed framework differentiates corporate exposures between:

- senior corporate exposures, and
- specialised lending exposures.

Similar to bank exposures, the HBA believes that, for rated corporates, it is meaningful to retain the current prudential treatment, which provides for risk weight treatment under the external credit assessments. On the contrary, it is doubtful whether the proposed approach will be effective enough to identify the risks inherent to corporate exposures. Pursuant to the consultative document, is provided for a one-size-fits-all approach, since there is no consideration of the significant divergences and specificities existing across industries. Therefore, we consider prudent to adapt the proposed risk drivers to industry type by introducing subcategories with separate risk-weights suitable for each industry. Furthermore, we question the ability to apply the proposed provisions in cases of exposures to corporates not obliged to publish accounts.

Finally, we urge you to revise the proposed provisions, which provide a discriminatory treatment against Small and Medium Sized Enterprises (SMEs), in two ways:

- SMEs are penalized due to low volume of revenues, which entails that exposures to them will receive risk-weights of 100%-130%, and
- in cases of SMEs not obliged to publish accounts, banks must assign risk-weight of 300%.

Therefore, the HBA recommends that the BCBS introduces two separate subcategories for corporates and SMEs with risk-weights appropriate for each category, in order to ensure not only a reliable method for measuring credit risk, but also credit availability to SMEs, which play a crucial role in terms of economic growth and employment.

With regard to ***specialised lending exposures***, we are particularly concerned for the prudential treatment of banks' ship financing exposures, which are included in object finance subcategory. According to the proposed provisions, these exposures should receive the higher of i) the counterparty risk weight, and (ii) risk-weight of 120%, which is definitely penalizing for banks engaged in shipping lending. Given that the physical assets (ships) acquired via bank funding are "high quality physical collateral", since they have exhibited in the past outstanding performance with regard to shipping market liquidity and tradability, as well as high recoverability of outstanding loans by enforcement of pledge, the HBA proposes the exclusion of ship financing from the ***specialised lending*** category.

The HBA suggests that the treatment of shipping exposures should be aligned with the prudential treatment of exposures secured by commercial real estate. More specifically, with regard to shipping assets that meet certain requirements (i.e. liquid secondary markets, high market tradability, low volatility), the risk-weight treatment of relative exposures should be determined under the ***Loan-to-Value*** ('LTV) ratio and the ***Debt-Service-Coverage*** ('DSC') ratio. In contrast to real estate exposures, where risk-weight treatment based on these risk indicators is come up with practical implications related, *inter alia*, to unavailability of updated information, in case of shipping exposures the relevant information is more easily accessible for the following reasons:

- there are well-established, reliable and publicly available market prices for collateral (ships), which makes it possible to calculate on a regular basis the denominator of the ***LTV ratio***, and
- the ***DSC ratio*** can be determined in a consistent way, as banks are capable to access to updated data on cash flows generated by ships, which is used for the loan repayment.

III. Retail exposures

The HBA is in favour of retaining the existing approach for retail exposures, which provides for a treatment of these exposures with a risk-weight of 75%. As far as the granularity criterion is concerned, we consider reasonable to set the limit for aggregate exposure to any single counterparty at the level of 0.5% of the retail portfolio.

IV. Exposures secured by residential real estate

The BCBS aims to harmonize global standards concerning exposures secured by residential real estate by introducing risk-weight treatment based on ***LTV ratio*** and ***DSC ratio***. Undoubtedly, assigning risk-weights according to specific risk drivers would enhance risk sensitivity and improve risk management procedures. However, a significant number of specificities existing across jurisdictions impedes the consistent implementation of a harmonised approach for capturing risk in residential real estate exposures.

Between the two proposed risk indicators, the LTV ratio seems more appropriate, since there is much available information and banks, as well as competent authorities, are already based on it in order to assess the risk inherent in relative exposures. However, there are certain aspects regarding the use of the LTV ratio for determining risk-weights, which should be given due consideration. Firstly, it is necessary to lay down a uniform definition of the LTV ratio, which could be applied in a consistent way across countries, regardless of the existing national circumstances, which could otherwise create an uneven playing field. Secondly, for the purposes of calculating LTV ratio, the value of any financial collateral should be taken into account.

The DSC ratio would be a good predictive risk measure, if banks had access to updated data concerning financial capacity of obligors. It is certainly difficult for banks to demand from borrowers to provide them on a regular basis with figures reflecting their financial capacity. Therefore, the DSC ratio does not seem suitable risk indicator and banks should, in the context of determining risk-weights, reckon, except for LTV ratio, on the age of the loan and the underlying reasons for granting a loan (i.e. whether it is for purposes of ownership occupancy or buying-to-let).

V. Exposures secured by commercial real estate

Treating exposures secured by commercial real estate as unsecured and assigning to them the counterparty risk-weights (OPTION A) is definitely inappropriate and misleading. Therefore, we are in favour of OPTION B, which reflects in a better way the bank’s losses incurred in case of obligor’s default, as an LTV approach recognises the value of collateral pledged.