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By email: baselcommittee@bis.org

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs,

Consultative Document: Reducing variation in credit risk weighted assets – constraints on the use of internal model approaches

We refer to the consultative document entitled “Reducing variation in credit risk weighted assets – constraints on the use of internal model approaches” issued by the Basel Committee on Banking Supervision (the “Basel Committee”) in March 2016.

On behalf of our members, we set out in the attached appendices comments on the proposals as set out in the consultative document. Appendix I contains comments on the overall approach and direction of the proposals contained in consultative document and Appendix II contains comments relating to specific texts in the document.

We hope you find our comments useful. Should you have any questions, please contact our Manager, Ms Emily Ngan at (852) 2526 6080 or our Officer, Ms Cathy Kuet at (852) 2567 1363.

Yours faithfully



Doris Ma
Secretary

Enc.

c.c.: Ms. Karen Kemp, Executive Director (Banking Policy),
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Chairman Standard Chartered Bank (Hong Kong) Ltd
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Comments on overall approach

Section 1 – Introduction/ Summary of Proposals/ Output floor

- 1) We support the aim of the Basel Committee to ensure the modelling of these credit risk RWAs framework is simple, transparent, consistent and comparable. We also appreciate the effort of the Basel Committee in ensuring banks continue to be strongly capitalized in a risk sensitive manner to support a resilient financial system. At the same time we acknowledge the challenge to limit variability in risk parameters and modelling exposures of similar risk classes in a reliable and consistent way.
- 2) We note that it is not the Basel Committee's intention to increase overall capital requirements for banks significantly. However, based on current proposals in this consultation document, we are concerned that the solutions put forward by the Basel Committee could lead to a significant increase in capital requirements for banks. We would appreciate if the Basel Committee can conduct a quantitative assessment for the potential impact and provide solutions to mitigate the risk of any unintended increases in capital requirements before finalising the proposal.
- 3) For example, member banks have estimated that the proposed capital requirement would far exceed those determined by regulatory stress tests and additional capital held in Pillar 2 buffers. Therefore, there is a risk that the proposal might impact the capital requirement across the banking sector more broadly, especially for those with the highest-rated clientele portfolio such as banks and large corporate exposures. Furthermore, it may encourage lending to less creditworthy counterparties since there is no capital incentive to hold safer but lower-yielding assets.
- 4) We are also concerned that the net effect of proposals will severely constrain the ability of banks to provide funding to corporates and end-users, particularly in jurisdictions where capital markets are less developed and where banks are the primary source of finance.
- 5) We believe that the objective of reducing variability of risk weights should be fundamentally addressed via harmonising key modelling input definitions such as default, down-turn, data sufficiency criteria, etc. It can also be addressed by

providing more specific guidance and clarifications issued by supervisors instead of introducing output floors. Member banks consider the proposed constraints to be too broad and conservative and it is likely to have significant unintended consequences for the broader economy. For example, the proposals are likely to have a disproportionate impact on the availability, cost and provision of credit in key emerging markets such as the majority of the countries here in the Asia Pacific region, where ratings are less common and therefore they are unnecessarily penalised under the Standardised Approach. Banks with large emerging market footprints will have to incur proportionally higher capital costs for providing funding to these types of clients.

- 6) Some banks are also concerned about the impact brought by the proposal to other traditional loan product such as trade finance and specialised lending. For instance, the provision of trade finance, which is especially important to SMEs and in emerging markets, will suffer from the introduction of Exposure at Default (EAD) floors and limitations on the determination of the Maturity (M) parameter, as well as the reversal of Bank exposures to the Standardised Approach as some of the common trade finance products such as letters of credit are treated as exposures to banks / FIs. Another example would be specialised lending, such as the provision of infrastructure / project finance, which may decrease with a reversion to Standardised Lending / Supervisory Slotting if no distinctions can be made for differences arising from improved structures that are meant to alleviate investment and financial risk. This may penalise emerging market economies where requirement for infrastructure and project finance is higher.
- 7) The proposed reversion of banks, financial institutions, and large corporates to the Standardised Approach will severely impact the credit risk mitigation effect offered by these stronger, lower-risk protection providers who are no longer treated as IRB exposures, as some major regulators disallow the recognition of guarantees to IRB exposures if the guarantor itself is not calculated on the IRB basis. We are of the view that CRM remains an important tool in reducing risk on lending and supports funding in developing countries as well as for new industries or new entrants which are not yet sufficiently established to access unsecured finance.

- 8) We believe it will be necessary for the Basel Committee to combine its revised set of IRB proposals with adjustments to the revised Standardised Approach in order to create a coherent package.
- 9) With regard to the possible introduction of a capital floor, we do not think the introduction of an output floor is necessary as any aggregate output floor will penalise low-risk lending strategies. In light of the numerous constraints already under consideration in this consultation, as well as other existing levers such as the leverage ratio, the need for an output floor would seem to be redundant.
- 10) In addition, member banks expressed a concern that as part of the revised credit risk RWA framework, whether the Basel Committee will recommend the local regulators to reassess those existing IRB approvals.
- 11) Lastly, in terms of the timeline, we understand the Basel Committee's ambition to finalise requirements by the end of 2016; but would caution that the suite of regulatory change underway—revisions to the Operational Risk framework, Market Risk framework, Counterparty Credit Risk framework and Credit Risk framework—is far-reaching in nature and represent a fundamental change to the entire regulatory capital framework. We would recommend the Basel Committee to carefully consider a holistic review and, where possible, a protracted timeline for testing, calibration and implementation.

Section 2 - Scope of use of internal models and recommendations

- 12) To mitigate adverse economic impacts and avoid capturing a population of exposures which is unnecessarily wide, we believe a more focused approach is needed to target exposures where there is insufficient data to justify modelling. Careful calibration of the proposed framework, along with coherent linkages to existing supervisory exercises such as stress testing, hypothetical portfolio and benchmarking exercises as well as governance requirements can help to address the shortcomings of the proposed framework.
- 13) We therefore propose that the following recommendations be taken into consideration in a revised IRB framework that is well-calibrated and proportionate.

- (i) A-IRB be permitted for those portfolios supported by recognised data consortia and data pooling initiatives,
 - (ii) a more targeted definition of portfolios with insufficient data be used to determine the scope of portfolios that will be constrained (refer to the section “*Defining the scope of portfolios ineligible for modelling*” below for recommendations), and
 - (iii) constraints are introduced through a more risk-sensitive version of F-IRB rather than the Standardised Approach.
- 14) We note that the Basel Committee has laid out three criteria for assessing modellability within the consultation. We set out below our specific comment on each of the criteria for consideration:.

i.) Data availability

Providing a policy framework to ensure robust, harmonised industry standards for data pooling

Data pooling through consortia or utilities is a powerful tool that can be leveraged to overcome concerns around data availability and information advantages for exposures with limited default history. We would also note that internal default data, while providing useful information with regards to credit risk, is not the only source of meaningful information to assess credit risk. Other such indicators for which publically available information exists include: annual financial statements, Pillar 3 disclosures, publically listed debt and equity prices and CDS instruments. A few examples of data pooling are included as below:

- Global Credit Data
- Moody’s Project and Export Finance (PEF) consortium
- Credit Benchmarking
- ICC Trade Register

We would therefore recommend that the Basel Committee develop a common set of minimum standards for data pooling that could be used to meet IRB regulatory requirements. Where the data pool meets a common set of minimum standards and requirements, this should warrant the use of A-IRB where data exists for PD, LGD and EAD parameters, and F-IRB where only data exists for the PD parameters. This would ensure greater harmonisation, robustness, governance, transparency and

confidence in data pooling; and support the continued use and betterment of the A-IRB framework.

ii.) Informational Advantage

- **Permit A-IRB for a wider set of exposures and introduce constraints through a more risk-sensitive version of F-IRB**

The Basel Committee has proposed that exposures to banks, other financial institutions and large corporates be subject to the Standardised Approach and that specialised lending exposures be subject to either the Standardised Approach or the Supervisory Slotting Approach. Our concern is that the way modelling constraints have been articulated is likely to result in the capture of an extremely wide population of counterparties, beyond portfolios which should be considered as so-called ‘low default portfolios’. Additionally, we are of the view that for many of these portfolios data pooling initiatives exist and justify the use of more risk sensitive approaches.

- **Defining the scope of portfolios ineligible for modelling**

Although we agree that banks, NBFIs, large corporates and specialised lending are exposures that typically suffer from data scarcity; it is inaccurate to assume that this applies to the full population of all obligors falling into these exposure classes. The classifications for corporates could be problematic, as it is unclear how the thresholds of EUR50bn in total asset and EUR200m in annual revenues are determined to drive the proposed Standardised and F-IRB approaches. We would recommend that the Basel Committee share further information on how the criteria / thresholds are defined, with a view to adopt a clearer scope of portfolios against which constraints could apply.

In this regard, the approach adopted by the UK Prudential Authority (PRA) Regulatory in its Supervisory Statement 11/13 (SS11/13) may offer a useful reference. SS11/13 sets out a series of extensive requirements for ‘low default portfolios’ relating to the estimation of PDs, LGDs and EADs including expectations related to statistical techniques used, the economic environment of data used, assumptions

on changes in portfolio composition, parameter choices and model philosophy. On PD estimates, SS11/13 specifies that where a firm's internal experience of defaults for a given portfolio is less than 20 and where reliable estimates cannot be derived from external sources of default data, then a portfolio shall be considered as 'low default.' Similar specifications are laid out for LGD and EAD estimates requiring 20 relevant data points. With regards to modelling techniques and validation, one of the Basel Committee's criteria for assessing modellability, SS11/13 also lays out expectations on acceptable statistical techniques to derive risk parameters and validation requirements.

- We would encourage the Basel Committee to consider adopting a similar approach to SS11/13 as this would not only allow firms to draw on external data sources to address areas of data scarcity, but it would also reduce the risk of constrained funding and negative economic repercussions arising from capturing a large set of exposure classes.**Introducing constraints through a risk-sensitive F-IRB**

Where internal or external data proves insufficient to address data gaps for exposures to banks, other financial institutions, large corporates and specialised lending, we see it as appropriate to introduce limitations on firms' abilities to model risk for these portfolios. However, some of our banks are of the view that a full disallowance of IRB is unwarranted as a complete removal of modelling will create a 'race for the middle' where there will be very little appetite or economic motivation to provide lending at either end of the risk spectrum. A more proportionate approach would be to introduce certain constraints on firm's ability to model LGD and EAD parameters, but maintain their ability to model PD. We therefore recommend that the Basel Committee to constrain modelling for portfolios with insufficient data availability via a more risk-sensitive version of F-IRB as laid out above in section 2.

iii.) Modelling techniques and validation

- **Enhance the governance requirements linked to models and strengthen the use of benchmarking and hypothetical portfolio exercises to target RWA outliers**

To complement these recommendations, we believe a greater focus could be placed on governance of internal models. In particular, the Basel Committee may wish to consider the merits of requiring firms to provide model risk appetite statements or articulate their model use policies. On the other hands, Hypothetical Portfolio Exercises (“HPEs”) are useful exercises if the HPEs are performed in a consistent and meaningful way. As HPEs are an important source of information in identifying RWA outliers, we would encourage the Basel Committee to continue its use of HPEs in order to track whether a reduction of RWA variance has been achieved. We would also like to ask the Basel Committee to consider and articulate what level of RWA variance it wishes to achieve. We think that a full standardisation of risk-weighted assets should not be the desired objective for a healthy and well-diversified financial system.

Similarly, benchmarking is a targeted way to identify RWA outliers. A number of firms already use benchmarking services to understand where their internal risk parameters are calibrated vis-à-vis their peers. The Basel Committee may wish to consider ways to leverage existing services such as those offered by Credit Benchmark in a more systematic and harmonised way to isolate and identify RWA variance on a more targeted basis.

- **Proposed floor to IMM-CCR and the removal of IMA-CVA may damage banks’ ability to provide liquidity and make markets.**

Some banks raised their concerns that the cost of offering derivative risk management products will rise on average because of the uplifts in risk weights against counterparties and hedging trades. IMM floors will also have negative consequences; particularly due to new margining requirements: when the IMM approach would be floored to SA-CCR we will see an arbitrary, but positive, capital contribution on top of the costs of funding the collateral which will ultimately be passed onto clients. This will significantly limit incentives for market players to enter in risk-mitigating contracts to hedge their specific economic needs.

Section 3 – Parameter floors

- 15) We have received positive feedback from our banks regarding to the Basel Committee’s considerations in calibrating of the parameter floors. In particular, banks welcome the consideration of the criterion such as “National specificities” of retail portfolios which takes into account of the specific national features. Banks also share the concern with the Basel Committee that the proposed floor could discourage them from adopting the IRB approaches and the associated risk management standards.

Probability of Default estimation

- 16) As stated in the consultation paper, there is, “a high degree of consistency in banks’ assessment of the relative riskiness of obligors. That is, there was a high correlation in how banks rank a portfolio of individual borrowers.” This suggests that allowing banks to model PD would make sense as it maintains an appropriate rank-ordering of risks. This is also appropriate as a full harmonisation of PD could unnecessarily penalise certain markets: for example, due to the geographic footprint, business strategy or customer base different banks will have more accurate PD estimates of different customer segments. This is particularly the case for banks operating in Asia Pacific and other emerging markets.
- 17) Accepting that an exposure can never be truly risk free, we see the merit introducing a minimum PD floor. However the Basel Committee’s QIS exercise seems to suggest that a more conservative input floor beyond the proposed 5 bps is being contemplated. We believe that the proposed input floor provides a sufficient degree of conservatism and should not be increased. An overly conservative PD floor should be avoided as it would result in penalising clients with strong credit profiles and encourage perverse and irresponsible lending practices.

Loss Given Default estimation

- 18) While there may be insufficient information to allow firms to fully model recovery and loss data and thereby justifying the introduction of supervisory foundation values for unsecured exposures, we believe there is merit in allowing

for a more granular recognition of collateral as per the A-IRB framework for secured exposures as long as they are supported by data.

- 19) This will not only introduce a positive incentive for firms to establish and enforce robust risk management practices, but will also recognise appropriate capital benefits for collateralised portfolios in the revised IRB framework. This will discourage banks to lend on an unsecured basis and will ultimately reduce cost for clients.
- 20) In particular, we note the proposed A-IRB secured LGD input floor of 20% for physical collateral seems unreasonably high and should be re-calibrated. Physical collateral is commonly required for important lending activities such as shipping and aircraft finance which are vital for economic growth.

Exposure at Default estimation

- 21) Similar to constraints recommended for LGD in the case of insufficient loss and recovery information, Foundation-IRB constraints would also be generally appropriate for EAD estimation.
- 22) The one notable exception would be the proposed A-IRB EAD/CCF input floors and their application to trade finance products. Due to their short-term and liquid nature and their importance in supporting global trade flows, we recommend that trade finance products be exempted from any EAD/CCF input floors.

Maturity

- 23) Any modelling constraints should not be extended to Maturity estimation. While some supervisory F-IRB parameters are appropriate, maturity is not self-estimated and thus doesn't contribute to the RWA variance. Furthermore, the fixed 2.5 year maturity parameter under F-IRB will overstate the actual maturity for a number of short-term transactions such as trade finance and repos/reverse repos and securities lending/borrowing transactions.
- 24) In January 2011 the Basel Committee recognised that the one-year maturity floor under the A-IRB is inappropriate for short-term self-liquidating trade finance instruments given their average tenor of well below one year. It also

removed the existing national discretion on the application of the waiver.¹ The Effective Maturity (i.e. repayment-weighted maturity for amortization loans) provisioned under A-IRB can better reflect the maturity risk dimension for exposures with predefined repayment schedule. We recommend that this treatment be maintained in the revised IRB framework.

Section 4 – Parameter estimation practices and fixed supervisory parameters

- 25) For section 4, majority of our comments are related to clarifications and recommendations to parameters such as the Probabilities of Default (“PD”), Loss Given Default (“LGD”), Exposure at Default (“EAD”) and Maturity (“M”) which are specific to the sections in the Consultation Documents. We have included these comments together with other specific comments to other sections in Appendix II for reference.

¹ <http://www.bis.org/publ/bcbs205.pdf>

Specific Comments

Sequence number	Section / Sub-section and paragraph number of the document to which the comments refer	Extracts of the document to which the comments refer (including page number)	Comments
1.	Section 2.1 Summary of proposals	“... In response, the Basel Committee proposes: • To remove the IRB approaches for the following portfolios, which as a result will be subject to the standardised approach to credit risk: - banks and other financial institutions; - large corporates (defined as corporates belonging to consolidated groups with total assets exceeding EUR50bn); and - equities. ...” (page 2)	The proposed change of removing the use of the IRB approach for certain portfolios could impact the IRB banks as some regulators require a minimum IRB coverage of 85%. We would suggest that the Basel Committee issue guidance for the minimum IRB coverage for local regulators’ consideration.

Sequence number	Section / Sub-section and paragraph number of the document to which the comments refer	Extracts of the document to which the comments refer (including page number)	Comments															
2.	Section 2.1 Summary of proposals	“The treatment of sovereign exposures is subject to an ongoing separate review, which is being conducted in a careful, gradual and holistic manner. ... To determine whether a risk or portfolio is suitable for modelling, the Basel Committee considered the criteria in the table below.” <table><tr><td colspan="2">Criteria for assessing modellability</td><td>Table 1</td></tr><tr><td>Criterion</td><td colspan="2">Description</td></tr><tr><td>Data availability</td><td colspan="2">The quantity and quality of relevant data available for the risk or portfolio</td></tr><tr><td>Information advantage</td><td colspan="2">Whether an individual bank has data not otherwise available to the broader market or has specific knowledge of the risk that will contribute to the reliability of the outcome (in other words, whether banks have an information advantage)</td></tr><tr><td>Modelling techniques and validation</td><td colspan="2">The availability of robust and generally accepted modelling techniques which are capable of validation</td></tr></table>	Criteria for assessing modellability		Table 1	Criterion	Description		Data availability	The quantity and quality of relevant data available for the risk or portfolio		Information advantage	Whether an individual bank has data not otherwise available to the broader market or has specific knowledge of the risk that will contribute to the reliability of the outcome (in other words, whether banks have an information advantage)		Modelling techniques and validation	The availability of robust and generally accepted modelling techniques which are capable of validation		In table 1 of section 2.1, the Basel Committee has laid down the criterion used for assessing the modellability, namely (i) data availability, (ii) information advantage and (iii) modelling techniques and validation. However, the treatment of sovereign exposures is subject to an ongoing separate review. We would like to clarify if the criteria for treatment of sovereign exposure are different from those in “table 1”.
Criteria for assessing modellability		Table 1																
Criterion	Description																	
Data availability	The quantity and quality of relevant data available for the risk or portfolio																	
Information advantage	Whether an individual bank has data not otherwise available to the broader market or has specific knowledge of the risk that will contribute to the reliability of the outcome (in other words, whether banks have an information advantage)																	
Modelling techniques and validation	The availability of robust and generally accepted modelling techniques which are capable of validation																	
3.	Section 2.1 Summary of proposals	<table><tr><td>Information advantage</td><td>Whether an individual bank has data not otherwise available to the broader market or has specific knowledge of the risk that will contribute to the reliability of the outcome (in other words, whether banks have an information advantage)</td></tr><tr><td>Modelling techniques and validation</td><td>The availability of robust and generally accepted modelling techniques which are capable of validation</td></tr></table> (page 3)	Information advantage	Whether an individual bank has data not otherwise available to the broader market or has specific knowledge of the risk that will contribute to the reliability of the outcome (in other words, whether banks have an information advantage)	Modelling techniques and validation	The availability of robust and generally accepted modelling techniques which are capable of validation	Some banks considered that the descriptions in Table 1 to be too simplistic for a complete understanding of the impact. We would appreciate if the Basel Committee could elaborate on the description of what “relevant data” refers to, what the standard to determine “the reliability of the outcome” is, and how the Basel Committee judges “robust and generally accepted modeling techniques which are capable of validation”.											
Information advantage	Whether an individual bank has data not otherwise available to the broader market or has specific knowledge of the risk that will contribute to the reliability of the outcome (in other words, whether banks have an information advantage)																	
Modelling techniques and validation	The availability of robust and generally accepted modelling techniques which are capable of validation																	

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4.	Section 2.2 Exposures to banks, other financial institutions and corporates	“The study found a high degree of consistency in banks’ assessments of the relative riskiness of obligors. That is, there was a high correlation in how banks rank a portfolio of individual borrowers. But the study also revealed notable dispersion in the levels of estimated risk, as expressed in the probability of default (PD) and loss given default (LGD), that banks assigned to the same exposures.” (page 3)	We welcome the result of the study conducted by the Basel Committee which showed that the overall models built by different banks for low default portfolios have good alignment in differentiating between the good and bad. However, some banks considered that the Basel Committee’s comment on the dispersion in the PD/LGD value assignment could actually be related to the differing risk appetites of banks. They are of the opinion that, as long as the model’s ranking order is satisfactory and the PD/LGD value estimation is conservative enough, banks should be given the option to put more capital buffer on a specific portfolio and such comparison could only reflect the difference in risk appetite among banks.

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5.	Section 2.2 Exposures to banks, other financial institutions and corporates	“It is difficult for banks to obtain reliable estimates of PD for low-default exposures.” (page 3)	We acknowledge the difficulties in obtaining the data to estimate the default data for banks, other financials and large corporates. However, instead of removing the IRB approach for exposures, some of our member banks suggest the Basel Committee to retain the IRB approach for but to set regulatory parameter floors instead.
6.	Section 2.2 Exposures to banks, other financial institutions and corporates	“ Furthermore, such exposures are usually highly rated by credit rating agencies and are the subject of significant market analysis. It is unlikely, therefore, that banks’ internal estimates of potential defaults or losses from such exposures will be any more reliable from a supervisory perspective than using estimates based on market data, on which the standardised approach to credit risk is based.” (page 3)	Under the SA framework, banks are allowed to use external rating agency’s rating of the obligor for the RWA calculation. Member banks stated that if the Basel Committee believes that the external rating agency’s rating result is a reliable source of PD, parity of treatment should be applied to the internal models which are benchmarked to the external rating, under a sound benchmarking approach; or in other words, an acceptable level of matching between internal and external rating, together with a reasonable coverage of externally rated obligors in the portfolio. Besides, there are various considerations for an obligor choosing to be rated or not by

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			external rating agencies. A “Not Rated” designation doesn't mean all those unrated obligors are of the same risk level and should deserve the same risk weight. We would recommend the Basel Committee to consider the impact of over reliance on external rating agencies as they conduct business on commercial terms.
7.	Section 4.1 Probability of default	“The Basel Committee proposes ... Specifically, the Basel Committee proposes that the following requirements be introduced for the modelling of PD under the F-IRB and A-IRB approaches: • Rating systems should be designed in such a way that assignments to rating categories generally remain stable over time and throughout business cycles. Migration from one category to another should generally be due to idiosyncratic or industry-specific changes rather than due to business cycles. • Data used to calculate PDs. Modelled PD should be based on the observed historical average one-year default rate, which must include a representative mix of good and bad years, with a minimum weighting of data from downturn years of one in ten. • Granularity of PDs. At a minimum, PD should be estimated for each rating grade.	There are three new requirements introduced by the Basel Committee in modeling the PD. However, the requirements do not provide sufficient guidance for our banks to implement. We would appreciate the Basel Committee to further elaborate on these requirements to facilitate our understanding and implementation. For example, we would like to clarify the exact meaning of the minimum data in the above context, i.e. can this simply be interpreted as the default data from the downturn years defined should make up no less than 10% of the full default samples, or does this refer to having at least one year as downturn over a period of ten-years (if assuming the development samples come from a period of

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		In addition to the changes above, which will apply to corporate exposures and...” (page 7)	ten-years)?
8.	Section 4.1 Probability of Default	“... the following requirements be introduced for the modelling of PD under the F-IRB and A-IRB approaches: • Rating systems should be designed in such a way that assignments to rating categories generally remain stable over time and throughout the business cycles. Migration from one category to another should generally be due to idiosyncratic or industry-specific changes rather than due to business cycles. • Data used to calculate PDs. Modelled PD should be based on the observed historical average one-year default rate, which must include a representative mix of good and bad years, with a minimum weighting of data from downturn years of one in ten. • Granularity of PDs. At a minimum, PD should be estimated for each rating grade. In addition to the changes above, which will apply to corporate exposures and, where relevant, retail exposures, ...” (page 7)	The proposed requirements on IRB model parameter estimation are expected to make IRB outputs more through-the-cycle and less prone to business cycles. We understand the Basel Committee would like us to consider the impact of business cycles in our estimation of PD, however, our member banks considered that this may make their IRB models less risk sensitive for internal risk monitoring purpose and hinder their risk management capability. We appreciate the Basel Committee to allow banks having more flexibility in the estimation process to reflect the borrower’s current condition and most likely future condition over the forecast horizon.

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9.	Section 4.1 Probability of default	“... for retail exposures. Currently, banks must adjust PD estimates upwards for anticipated seasoning effects. However, the Basel Committee believes that instead of encouraging banks to adjust estimated PDs, they should instead be required to take account of seasoning as a risk factor in their models.” (page 7)	We would recommend the Basel Committee to elaborate its concerns in detail and provide the rationale why taking seasoning effects in risk factors is more preferable than an add-on PD adjustment. As part of the risk management process, we think that banks should be given the option to use their own appropriate methodology in handling seasonal effects while satisfying the Basel Committee’s key concern.
10.	Section 4.2.3 A-IRB: unsecured exposures (corporate and retail)	“...As an alternative, the Basel Committee is considering whether to use supervisor-specified add-ons for the downturn component...” (page 10)	We understand the Basel Committee’s rationale in introducing the supervisor-specified add-on for the estimation of the LGD. However, for the retail portfolio, some banks recommend the Basel Committee to allow them to derive the downturn LGD (or add-on) from the empirical experience, provided that the historical loss data is sufficient.
11.	Section 4.2.5 Exposure A-IRB modelled and collateral not modelled	“The Basel Committee considered the case where a bank has a portfolio of unsecured exposures for which it is permitted to apply the A-IRB to model LGDs. If the bank takes collateral against one of these exposures, it may not be able to model the effects of the collateral (i.e. have enough data to model the effect of the	We welcome the proposal for the use of a combination of self-estimated LGD_{unsecured} and FIRB-estimated LGD_{secured} in the event of insufficient internal data to model the collateral recovery.

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		collateral on recoveries). In such cases, the Basel Committee proposes that banks be permitted to apply the formula for fully and partially secured exposures in the F-IRB (see section 4.2.2) to determine the collateral effect, with the exception that the LGDu term would be modelled by the bank (according to the approach set out in section 4.2.3), rather than being fixed by supervisors.” (page 10)	We would like to clarify or suggest that the same approach be applied for the scenarios where the banks are able to model the collaterals but have insufficient data for the unsecured LGD estimation.
12.	Section 4.3 Exposure at default and credit conversion factors	“... ii. A well-known feature of the commonly used undrawn limit factor approach to estimating CCFs is the region of instability associated with facilities close to being fully drawn at the reference date. Banks should ensure that their EAD/CCF estimates are effectively quarantined from the potential effects of this region of instability. ...” (page 11)	In modelling of the EAD parameters, the Basel Committee acknowledges that the region of instability is indeed one of the common issues to tackle in the CCF modeling and one area causing variation in estimation. Given that there are alternative modelling techniques to handle such situations. We would recommend the Basel Committee to provide further guidelines, e.g. the quantification and the treatment of the issue, with the aim of ensuring better consistency.

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13.	Section 4.3 Exposure at default and credit conversion factors	“... Regarding unconditionally cancellable commitments, the definition of ‘commitment’ will be clarified. Some banks currently treat facilities that are unconditionally cancellable as not being a commitment and thus deem them to fall outside the scope of the capital framework. In response, the Basel Committee proposes the following definition of ‘commitment’ in both the standardised and IRB approaches: <i>commitment means any contractual arrangement that has been offered by the bank and accepted by the client to extend credit, purchase assets or issue credit substitutes. It includes any such arrangement that can be unconditionally cancelled by the bank at any time without prior notice to the obligor. It also includes any such arrangement that can be cancelled by the bank if the obligor fails to meet conditions set out in the facility documentation, including conditions that must be met by the obligor prior to any initial or subsequent drawdown under the arrangement.</i> As set out in section 3, the Basel Committee proposes that, for the limited types of facility that may still be modelled under the A-IRB, the EAD will be subject to a floor.” (page 11 - 12)	One common scenario that usually results in variations in commitment recognition, and therefore EAD treatment, is the pre-conditions associated with the contract. There are a number of circumstances under which a bank is legally committed but where pre-conditions exist that would preclude actual drawings. These conditions can vary, but can include mandatory regulatory or completion approval, subsequent credit reviews by the lender, and shareholder approval in the case of mergers and acquisitions. Currently the treatment of these exclusions is not consistent across jurisdictions and banks. We would, therefore, recommend the Basel Committee to provide more specific guidance on how to classify different kind of commitment to promote consistency across regions.

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14.	Section 4.4 Maturity	“The Basel Committee proposes that banks be required to determine the maturity parameter (M) under A-IRB based on the expiry date of a facility (i.e. the use of the repayment date of a current drawn amount would be explicitly prohibited).¹⁴ This would be a clarification of paragraph 320 of Basel II that already provides that M should be set to the maximum remaining time that a borrower is permitted to take to fully discharge its contractual obligations under the terms of the loan agreement (subject to a cap of 5 years). The Basel Committee does not propose to change the fixed 2.5 year maturity parameter under F-IRB.” (page 12)	We would like to clarify that the existing provision under A-IRB in which the Effective Maturity (i.e. repayment-weighted maturity) can be used for the amortizing exposures with pre-defined repayment schedule is not within the scope of the above revision, and will continue to be allowed.