

Paris, 9 March 2018

To the attention of
Basel Committee on Banking Supervision

Regulatory Treatment of Sovereign Exposures

Dear Ladies and Gentlemen,

The International Chamber of Commerce (ICC) Banking Commission welcomes the opportunity to comment on the discussion paper regarding the regulatory treatment of sovereign exposures published by the Basel Committee on Banking Supervision (BCBS).

As the industry body representing global banks active in the area of Trade and Export Finance, our comments and recommendations which are attached to this letter are focused on the impacts on this industry and the wider trade landscape.

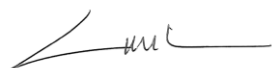
It is important to highlight that commitments made public Export Credit Agencies (ECAs) on behalf of their Sovereign are important to commercial banks which are financing international trade. Hence changes in the treatment of the regulatory treatment of sovereign exposures might have unexpected consequences on international trade flows, especially for SMEs and less-developed economies.

By way of background, the ICC Banking Commission is a leading global standard-setting body for the banking industry. For over 85 years it has held a key role in bringing the industry together as well as promoting cooperation and stability in cross-border trade by providing a forum for professional exchange among its 600+ members in 93 countries.

The ICC Banking Commission highly appreciates the opportunity to respond to the specific queries raised by the BCBS in the discussion paper.

We remain at your disposal to exchange views on this topic.

Yours sincerely,



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Banking Commission

Discussion paper The regulatory treatment of sovereign exposures

Q1. Are there any additional sources and channels of sovereign risk in the banking system that are relevant to, and that should be captured in, the prudential regulatory treatment of sovereign exposures?

Q2. Are there additional roles of sovereign exposures in financial markets and the broader economy that are of relevance to the prudential regulatory treatment of sovereign exposures?

Export Credit Agencies (ECAs) play a vital role to bridge market gaps in medium and long term financing and to support export oriented corporates incl. SMEs in global trade, export and investments. On behalf of their sovereign governments ECAs safeguard jobs and employment in the export oriented industry by covering/insuring/guaranteeing export credits provided by commercial banks to borrowers in overseas markets. The ICC Trade Register provides empirical evidence that the ECA business is low risk profile business – even in crisis scenarios. Any new regulation should avoid a negative impact on trade and export finance, especially if ECAs are involved.

The Berne Union, which groups 85 trade-insurers established in 73 countries recently released some data on the activity of its members:

- *In 2017, trade insurers, including ECAs, issued covers for a total amount of \$ 1.873 bn*
- *12% of international trade flows (registered by the WTO) benefited from these covers*
- *Half of these covers were delivered by ECAs acting with the support of their national treasuries.*

The beneficiaries of this cover are exporters and banks which offer financing facilities to exporters. In addition to credit insurances (which protect the insured against a financial default of the buyer of the goods and services), most ECAs also offer some financial supports to exporters which need prefinancing, technical guarantees.

It is also important to mention that ECAs established in OECD countries decided in the 90's to implement minimum premiums to secure the financial sustainability over the long-term. This objective was reached: according to data published by Export Credit Group of the OECD, since 1999 ECAs of the OECD have been able to cover with charged premiums all their operating costs and the claims they paid. As a consequence, recoveries generate fiscal surplus and the long-term financial sustainability of ECAs is secured without any need to funding of national treasuries. This is confirmed by the ICC Trade Register which is based

on empirical default data submitted by the major commercial banks. The importance of recoveries should not be underestimated.

- *In its annual report, the Berne Union mentioned that its members paid claims for \$ 42 bn from 2007 until 2016 but also recovered \$ 42 bn over the same period. These data have to be managed cautiously as recoveries can refer to operations which were indemnified earlier but show the importance of recoveries in the business model of credit-insurers*
- *The last version of the Trade Register of the ICC mention that commercial banks*
 - o *Recover the whole portion of their loans covered by ECAs in case of a default of the borrower*
 - o *Recover over the time 74% of the uncovered portion of these loans*

In a Standardized Approach, the portions of loans covered by ECAs (usually 90 to 100% of the exposure) are dealt as pure Sovereign exposures although for banks a default would occur only after a double-default, first from the borrower established in a third-country and then from the ECA itself. For a bank, the financial risk presented by a borrower is decorrelated from the risk of the Export Credit Agency or its Sovereign.

Q3. What are your views on the potential definition of sovereign exposures?

It is worth mentioning that the Basel Committee for Banking Supervision has considered since 1990 exposure on ECAs as exposures on their Sovereign. ECAs are acting as part or on behalf of the government and should also be considered as sovereign exposure in the future.

When these ECAs benefit from a clear financial support of their Central Government, exposures on these ECAs should be considered as exposures on the Central Government. In other cases, exposures on these ECAs might be considered as other Sovereign exposures.

Q4. Do you agree that the definition of domestic sovereign exposures should be based on both the currency denomination of the exposure and the currency denomination of the funding? How would such a definition be operationalised in practice?

Not necessarily. In the ECA world, ECAs issue commitments in several currencies but if their guarantees are called they indemnify in most cases in their domestic currency, which limits the need for foreign currencies.

A cover issued in a foreign currency will require, if it is called, a funding in the domestic currency and hence it should be dealt as a domestic exposure.

In addition, as mentioned previously, ECAs are able to generate their own resources in foreign currencies as they recover most of their claims over the time and receive premium in the currency of the loan

Finally, to make a difference according the currency of the loans would create distortions among exporters as most trade flows are paid in a few currencies. The ICC Report on Trade Finance (Rethinking Trade Finance 2017) mentions that for Letters of Credit, the USD is the currency that represents 81,95% of the total value (converted to USD) of MT 700 issued via SWIFT. The euro represents 7,47% and Chinese Yuan or Renminbi (CNY or RMB) represents 5,12% of the total value.

According to the TXF Report on Export Finance for 2017, 70% of export credits are signed in USD and 25 % in €. Exporters based in the USA and in a lesser proportion in the € zone would be given a competitive advantage vs their competitors if the buyer is requesting an export credit to finance its purchases.

Q5. Do you agree with the potential relative rank ordering of different sovereign entities and with the principle of a potential risk equivalence criteria for treating certain non-central government exposures as central government exposures? Do you have any comments on the criteria?

No. All commitments made directly by a central government or indirectly by a public entity which is clearly and explicitly supported by the central government should be dealt the same way.

Q6. Do you agree that capital requirements for sovereign exposures cannot be modelled robustly, and that such exposures should be subject to a standardised approach treatment as a result?

For large banks, ECA supported export credits are managed with an IRB approach and there is no need to change this.

The ICC Trade Register provides empirical evidence for a sufficient modeling. It also provides empirical evidence that the ECA business is low risk profile business – even in crisis scenarios.

Q7. What are your views about how a standardised approach treatment for sovereign exposures should be designed and calibrated? How should such an approach balance simplicity, comparability and risk sensitivity? Are there any holistic considerations which could justify a differentiated treatment across different types of sovereign entities, including the relative treatment of central bank and central government exposures?

Whilst, we acknowledge that the Standardized risk weights are provided as an example in Table 6, we note nevertheless, that if adopted, they would mean that the risk weight percentages for an ECA-guaranteed exposure rated AAA to A- could range from 0-3% (for 'domestic-currency central government exposures'), to 10% (for 'foreign-currency central government exposures'), and up to 25%, (for 'other sovereign entities'), depending on which exposure sub-category the ECA would be allocated to.

This is not in line with our experience of default risk related to exposures guaranteed by ECAs as we have no experience of a defaulting ECA. If exposures guaranteed by ECAs result in financial institutions exceeding their large exposures limits, or increased capital charges, they would naturally seek to reduce these exposures, thereby limiting the funding available to the financing of trade, export and infrastructure projects.

We also wonder if the use of OECD country risk classification; mentioned in Table 6, is still appropriate at least for the exposure on ECAs :

- (i) the OECD classification is not intended to reflect solely an assessment of the sovereign credit risk, but reflects other considerations, not strictly economic*
- (ii) those classifications are not intended to be reviewed on a dynamic basis, but only when major changes occur or at least once a year.*
- (iii) rich countries are not classified anymore by the OECD*

Q8. What role could specific non-rating indicators play in determining sovereign exposure risk weights in the potential standardised approach?

An ECA cover creates additional discipline on the borrowers side to repay debts on time, in part due to the transparent nature of the ECA cover (the borrower is fully aware that the loan is covered by the ECA and is therefore aware that a default would be a default against the ECA as well as the commercial bank acting as lender). If a borrower defaults under an ECA covered export credit it becomes much less likely that other ECAs will provide him with an export credit in the future. For a commercial bank a substantial loss would only occur if the borrower and in addition also the ECAs fails to perform (double default) which is even less likely due to the uncorrelated default probabilities of the borrower and the exporter's ECA.. Debts overdue under ECA covered loans are also subject to Paris or London club based restructurings.

Q9. What are your views regarding the potential marginal risk weight add-on approach for mitigating sovereign concentration risk? Do you have any views on the potential design, granularity and calibration of such an approach?

Banks often need for sovereign debts to manage their liquidity ratio. If for any reason, a bank has an important sovereign exposure, the introduction of a risk-weight add-on might generate the creation of different types of Sovereign exposures to define assets to be kept and assets to be sold. One criteria of selection might be the liquidity of these assets. Sovereign exposures such as loans covered by ECAs which are less liquid than T bonds might be sold in priority. Commercial banks might disregard that type of loans. This would be paradoxical as the risk weight should only reflect the quality in term of risks; banks are at risk on export credits when there is a double-default which is not considered in risk-weights in a Standardized Approach.