

**ABI response to the BCBS consultation on Reducing
variation in credit risk-weighted assets – constraints on
the use of internal model approaches**

24 June 2016

KEY POINTS

1. While harmonization of some technical definitions is more than welcome in order to enhance the credibility of the IRB models, we would nevertheless expect an appropriate balance between risk sensitivity and simplification, since too high a degree of simplification and conformity in parameters and models could spawn negative effects for both the banking business and the wider economic environment. In general terms, we would therefore request that the regulator retain the use of the internal models to greatest possible extent.
2. The proposed revision of the IRB approach cannot be assessed on a stand-alone basis. This is especially relevant insofar as it would imply that some asset classes are treated with the standardized approach for credit risk, whose revision is in turn ongoing, and in view of revision of the overall regulatory floor.

Whilst we would expect the cumulated impact of the proposed reforms to be consistent with the aim of BCBS proposals "not to significantly increase overall capital requirement", our preliminary estimates show that their joint effect would be relevant. We would therefore encourage the BCBS to await the results of the QIS and if the overall effect of the proposals was material to modify them in order to avert any potential negative consequences for the revamp of the economy.

We would also take into account the current engagement of the European regulators and of the European banking industry in the improvement process of internal models, aimed at achieving greater comparability and eliminating inconsistencies in existing models.

EBA is working on these topics through its recent supervisory benchmarking exercise and with multiple studies that identify as a priority the harmonization of the concept of default; additionally, the SSM/ECB launched in 2016 the Targeted Review of Internal Models (TRIM) with a view to fostering consistency and accuracy in the use of internal model within the SSM.

All the above being considered we would ask the regulator to keep the dialogue with the banking industry open, even once the consultation is over and, in order to analyze and discuss the results of current initiatives, we ask that the publication of the BCBS final framework be postponed to 2017.

3. As for the specific proposal envisaged during the consultation, at this stage, the adoption of new floors based (also) on the value of the CCF Standard (increased in the current proposal of standardized approach revision) is one of the major areas of concern for the industry. It seems excessively conservative especially in light of such a disadvantageous new standardized approach which would be the 'base' for calculating the proposed floor. We make special reference to the 50% - 75% range currently envisaged for non-retail counterparties. A sharp increase of CCFs would result in an additional capital charge which seems unjustifiable for commitments which are

unilaterally cancellable without prior notice by banks as soon as the ongoing credit monitoring procedure detects signs of deterioration of creditworthiness. Banks would lose their incentives to grant unconditionally cancellable commitments which are, incidentally, of fundamental importance in supporting the daily business activities of large, medium and small companies.

4. The restrictions on the potential scope of application of the AIRB approach is another area of concern. We refer in particular to the threshold related to corporates belonging to consolidated groups with total assets less than, or equal to, EUR50bn and annual revenues greater than EUR200m. These are widespread in the Italian productive system. We would at least suggest that the F-IRB be envisaged for both business categories.
5. Under F-IRB, the Committee does not propose to change the fixed maturity parameter (2.5 year). We believe this fixed parameter could frustrate institutions specialized in short term finance, discouraging the investment in internal models for "standardized" institutions and at the same time unduly penalizing those that already adopted A-IRB. We therefore suggest to provide, under the F-IRB approach, two buckets of regulatory fixed values for the parameter M, i.e. $M = 1$ year for exposures with duration up to one year and $M = 2.5$ year for the rest.
6. The treatment reserved to large corporates with consolidated assets greater than EUR 50bn is another issue fraught with problems. It can lead to strongly penalising medium and small-sized firms belonging to large groups as the asset/revenue thresholds to decide on whether to use the standardized approach, or F-IRB, or AIRB are applied at a counterparty rather than a group level. We would therefore recommend that the asset/revenue thresholds employed to decide on using credit risk models be applied at a counterparty rather than group level.
7. The proposal to apply a floor to the downturn add-on in addition to the floor on the overall LGD overlaps inappropriately with the general parameter floor, and creates a complex framework that warrants further clarification. We must resolve exactly how these LGD floors will interact if double counting is to be avoided.
8. The decision to remove the internal model approach (IMA-CVA) from the available options in the revision of the CVA risk framework seems questionable and, as the standardized regulatory model for CVA would diverge substantially from the managerial CVA models, it is likely to limit risk sensitivity and to be at variance with objective of reducing the gap between managerial and regulatory CVA
9. The underlying calibration methodology of the proposed risk parameter floor system architecture is unclear and to some extent inconsistent; moreover, not only does it add complexity, it also seems unnecessary for low default portfolios and unduly disadvantageous for retail and corporate (with the exception of very large companies) portfolios

GENERAL REMARKS

The Basel Committee has embarked on an all-encompassing revision process of the banking regulatory capital framework in light of the divergences between the results of the internal models. Although we recognize the merits of such a revision which aims to enhance RWA comparability and reduce unjustified bank variability, we believe that the decision to simply remove the internal models rather than addressing the root causes of their discrepancies might be the simplest way to handle the problem, but certainly not the most efficient or risk sensitive.

We deem it to be fundamental to retain the use of the internal models to the greatest possible extent. They proved valid in being the most risk sensitive way to calculate minimum capital requirements and have actually incentivized the development, implementation and ongoing fine-tuning of effective risk management practices and methodologies. In this regard, the "criteria for assessing modellability", as mentioned in par. 2.1 of the Consultation should be better specified, and not seen in an excessively restrictive way.

While the proposed treatments basically dismantle risk-sensitive models, this approach appears to be incoherent with the Basel Committee's focus on risk appetite and risk culture. It is important to highlight that one of the most important objectives of risk-based regulation is bank portfolio differentiation by risk profile: the transition from Basel 1 to Basel 2 was primarily justified by the need to ensure that banks supported their risk management best practices and that banks with low-risk profile, connected to their business model, enjoyed capital benefits.

Risk-sensitivity in banking modelling systems is a vital aspect and should not be pushed aside in favour of simplicity and comparability. A good compromise could be for the regulator to set certain criteria to be taken into consideration such as the level of justifiable RWA and parameter variability for certain asset classes and the degree of cyclicity of the rating systems. Banks could thus model the risk parameters while maintaining a certain flexibility in the model development in compliance with regulatory and business requirements, and perform the validation process using an adapted calibration framework.

Moreover, we urge the regulators to bear in mind the fact that while pursuing the objective of enhancing comparability, the increased level of standardization of the approach goes to the detriment of risk sensitivity and might incur some undesired consequences which should not be disregarded:

- o banks would not have any incentive to effectively monitor credit risk and those which have been so far more virtuous in terms of risk management would be unfairly placed on the same level as the others;
- o having the same flat cost of capital, banks would prefer to finance relatively riskier and, hence more profitable, counterparties (i.e. risk of adverse selection);
- o instead of stimulating convergence between the economic and regulatory capital (which is a precondition for increasing market transparency), the RWA comparability

achieved between banks would, conversely, lead to an overall reduction in the convergence between these two measures (the new IFRS 9 foresees the use of internal models for provisioning; should they be abandoned for regulatory capital purposes, this would inevitably widen the gap between the economic and regulatory capital);

- o it would encourage so-called herd behavior amongst banks which would tend to invest in the same types of assets characterized by relatively low capital absorption, therefore potentially amplifying systemic risk in the event of crisis.

We therefore feel it to be crucial for the regulator to undertake a revision of the IRB approach in order to address such shortcomings which generate unjustifiable discrepancies in their outcomes, whilst enabling banks to retain the approach which is the key driver to continuously improving bank risk-management practices.

While harmonization of some technical definitions (e.g. the definition of default) is entirely welcome in order to enhance IBR model credibility, we feel there should be an appropriate balance between risk sensitivity and simplification: too high a degree of simplification and conformity in parameters and models could lead to negative repercussions for both the banking business and the wider economic environment.

Another aspect worthy of consideration is the question of the understandable differences - with a certain level of confidence - between RWAs, because of model parameters and assumptions, differences in accounting rules and local consumer protection laws, different supervisory approaches across jurisdictions and finally because of the diverse risk profiles and recovery practices of each single Bank.

The simultaneous revision of the standardized approach and internal models, together with the discussion on capital floors, makes it basically impossible for banks to accomplish a comprehensive analysis, prevents them from assessing the joint impact of all these reforms and jeopardises the reliability of long-term strategies. As a consequence, with specific regard to this proposal, we believe its impact cannot be assessed without first gaining a clearer view of the possible developments of the standardized approach, particularly in view of: (i) the adoption of specific floor on risk parameters and (ii) the revision of the overall regulatory floor. In this context it should be noted the importance of consolidating and assessing the QIS exercise conducted on the revision to the Standardised Approach and the QIS exercise for IRB approaches. At this stage, it should be observed, for example, that for internally-estimated CCF parameters, the adoption of new floors based (also) on the value of the CCF Standard (increased in the current proposal of standardized approach revision) might represent a particularly conservative solution, not entirely in line with the aim of BCBS proposals ("not to significantly increase overall capital requirement").

In general, the proposed constraints on the use of the internal model approaches, including the proposed parameter floors and the removal of the IRB approach for financial institutions, large corporates, specialised lending seems to make capital requirements more conservative.

Preliminary estimates clearly show that the joint effect of the Basel's regulatory reforms would not be capital neutral. As this is not the stated objective, we eagerly await the results of the QIS to ascertain whether the current proposals actually maintain the same level of capital requirement for European banks. If the overall effect were to be substantial, it might lead to a potential credit crunch with potentially dramatic consequences as regards revamping the economy. This is why we wish the regulator to keep the dialogue open with the banking industry in order to discuss the results of the QIS and assess the adequacy of the approach calibrations.

COMMENTS ON THE SPECIFIC PROPOSALS OF BCBS

Observations with regard to specific changes envisaged in the consultative document are presented below

1. SCOPE OF USE OF INTERNAL MODELS

- o We acknowledge that the decision to step back to the standardized approach for low data portfolios (like income producing real estate - IPRE) results from the internal models presumed inability to produce robust estimates in absence of a significant pool of data. However, banks are provided with a number of information and data about these portfolios and perform a deep-dive analysis which is much informative. Hence the lack of historical information is more than compensated by a variety of figures which enable an overall assessment. Hence we would propose that the regulator defines more stringent modelling methodological standards and stress the margins of prudence without eliminating them at all
- o Specialized lending, and especially Project Finance, Shipping and IPRE, would all be particularly penalised by the current Basel Committee proposal. Yet these activities generally represent a flyer for the entire economy, in particular during the recovery phase of a downturn

a. EXPOSURES TO BANKS, OTHER FINANCIAL INSTITUTIONS AND CORPORATES

- o The proposed restrictions on the potential scope of application of the AIRB approach are of prime importance. We refer in particular to the threshold relating to corporates belonging to consolidated groups with total assets less than, or equal to, EUR50bn and annual revenues in excess of EUR200m. Such entities are widespread in the Italian productive system.
- o Firstly, we fail to comprehend the reasoning which led the Committee to reserve such a diverse (and highly disadvantageous) treatment to large corporates with consolidated assets in excess of EUR 50bn. This contrasts with all those large corporates belonging to groups with revenues in excess of 200 mn which can use F-IRB. Therefore, at the very least, we recommend that the F-IRB be envisaged for both types of companies. This approach would also offset any pricing distortions that

might occur for those large corporates with total assets over EUR 50bn (in particular for those investment grade) as opposed to mid-corporates (TA < EUR 50bn), with the latter potentially benefiting from more competitive pricing in view of the lower average cost of capital.

- o Secondly, the harsher treatment reserved for large corporates with consolidated assets greater than EUR 50bn seems illogic considering the fact that the largest exposures are the very ones susceptible to greater public disclosure, thus enabling banks to perform a more thorough assessment of counterparty creditworthiness.
- o Moreover, due consideration should be given to the combined effect of both this proposal and the revision of the standardised approach for credit risk. The standardized approach is particularly penalizing for unrated counterparties – which could see their risk weights being multiplied by a significantly high factor - and given the notable number of corporates which are not externally rated, the proposal to abolish the internal model poses a certain risk of severely hindering any resurgence of the economy.
- o We feel that these portfolios ought to retain the use of the IRB Approach, with the option - wherever necessary and as indicated by an analysis of shared and simple criteria - of data pooling, in particular for LGD and CCF. Whenever the approach remains Standardized we request the Supervisor to allow the extension of the external rating to corporates belonging to a consolidated groups "...in order to not significantly increase overall capital requirements...": about 50% lack external rating.
- o Although it is not in the scope of this consultative paper, the decision to remove the IRB option for certain exposure, i.e. large corporates, makes even more necessary, under a wider perspective, that also the Standardized Approach recognizes the purchased receivables approach where eligible (i.e. option to use the risk weight applicable to the debtor and to adopt a "top down" approach) as well as a specific and more favorable risk weight for exposures collateralized by purchased receivables (i.e. 50%) in order to avoid a counterintuitive penalization of the larger clients, for whom the IRB approaches won't be available, with respect to the smaller ones. It becomes, in this perspective, necessary as well that the SA recognizes a more favourable risk weight for leasing exposures collateralized by Other Physical Collaterals. Moreover, a proper scheme for the treatment of credit insurance on purchased receivables should be adopted.
- o Finally, considering that the corporate counterparties would be discriminated based not only on their own assets/revenues, but also on consolidated ones, mid-corporates and SMEs belonging to large groups would be seriously penalized. Moreover, we deem that this approach would create some inconsistencies:
 - it seems to be in contrast with the CRR principle according to which any counterparty should have its own rating assessing its creditworthiness (whether it belong to a group or not is a secondary point);

- it is not clear which definition of group should be used.
- o Therefore, we tentatively suggest that asset/revenue thresholds used to differentiate between the standardized approach or F-IRB be applied at counterparty rather than group level;
- o The standardized model to be applied to banks and large corporates promotes a one-size-fits-all approach which is inconsistent with the heterogeneous nature of those asset classes. We feel it to be appropriate to have, at the least, a more granular regime within each asset class by distinguishing, for example, between the Insurances (due to the different risk drivers) and Banks (e.g. Small versus Large). As regards data pooling, the Supervisor could define a benchmark portfolio or allow a shared sample to be defined (i.e as long as it guarantees at least a 75% coverage of the analysed segment) for the parameter estimation (PD/LGD) but allow banks to calibrate according to specificity with a certain degree of flexibility (different risk profiles and recovery practices of each Bank).

b. SPECIALISED LENDING

- o The removal of the IRB approaches for specialised lending, leaving only the “new” standardised approach and the IRB supervisory slotting approach, seems highly penalizing for the specialized lending and in particular for the shipping industry, as:
 - approximately 70% of shipping industry bank financing is provided by IRB banks, who have sufficient data to estimate with a good level of certainty the PD and the LGD.
 - there is evidence that the average LGD is very low, as it is the expected loss which stood at around 0,13%
 - the secondary market is very liquid, so it looks that these exposures are backed by collateral that can be even more liquid than those set for commercial real estate (CRE)
 - this category of SL is substantially similar to commercial real estate (CRE), demonstrating sustainably low credit losses as per paragraph 49 of the proposals - Revisions to the Standardised Approach for credit risk -, with the same requirements/eligibility criteria in as set out in paragraph 50 being fulfilled¹.

¹ In particular:

- (i) Ship loans are guaranteed by first line shipping mortgages with a loan-to-value Ratio (LtV) generally well below 80%;
- (ii) Quality of the guarantees is good. The ship secondary market is sound and liquid. On average every year a percentage between 6% and 10% of the ships in terms of world tonnage is traded on the secondary market;
- (iii) Ship loans are more granular and less volatile than commercial real estate loans;

- o We therefore ask for an equivalent treatment between the exposures guaranteed by a shipping mortgage and those guaranteed by mortgages on commercial real estate. In particular, in order to calculate the Risk Weights to apply to these exposures it is required to allow the IRB approaches, as for CRE.

c. EQUITIES

- o A combination of removing models and the proposal for the CRSA leaves equity exposures with a severe handicap. Not only would they be deprived of the risk sensitiveness offered by IRB models, but they would also be treated according to a new and more conservative standardised approach. In fact, the SA treatment proposed in the recent BCBS second consultative document for equity exposure to banks and other financial institutions (RWs 250%) seems to be inappropriately disadvantageous, if compared with the current IRB that envisages a range of approaches for equity exposures (e.g Simple risk weight approach, PD/LGD) related to the different equity investments portfolios. We therefore propose that the current range of IRB approaches be maintained.

d. COUNTERPARTY CREDIT RISK AND CVA

- o The removal of CVA IMA entails a series of drawbacks that could potentially increase the industry's cost of capital, resulting in additional burdens on the derivatives market-making activities.
- o The BCBS's decision to do away with the internal model approach (IMA-CVA) from the available options in the revision of the CVA risk framework seems questionable.
- o Methodological motivations to break the alignment with the Fundamental review of the trading book (FRTB) framework are not fully explained. The IMA approach does not add relevant complexity as compared to the standardized approach, because the main methodological challenge for both approaches is the calculation of CVA sensitivities. The calculation of the expected shortfall, even in the multi-liquidity horizon context of FRTB, is only a different, more risk sensitive aggregation of the same set of sensitivities.
- o The standardized regulatory model for CVA will diverge substantially from the managerial CVA models, limiting risk sensitivity and contradicting the 2015 declared purposes, i.e. narrowing the gap between managerial and regulatory CVA.
- o The CVA risk management practices adopted by banks are indeed very tailored and differentiated across markets and institutions, reflecting strategic choices on CVA risk

(iv) According the Consultative Document, the approach by due diligence is viable for shipping considering this industry is usually audited by relevant specific Authorities/Regulators deputed to apply the International Maritime Organization (IMO) code.

hedging and banks' business models. This heterogeneity in risk practices, that by their very nature are not amenable to standardization, makes the introduction of a mandatory standard model particularly detrimental to risk sensitivity.

- Even the communication process adopted by BCBS for the decision is not immune to criticism. It came out of the blue after the consultation paper on CVA reform issued in summer 2015, providing revised internal and standardized methodologies, and two QIS. The decision was announced in a consultation paper regarding IRB methods, stymieing all efforts requested only the previous month to produce the quantitative impact study (launched in February).
- Moreover, this initiative thwarts any efforts made to implement the Basel III CVA framework which is quite recent (CVA VaR models were built up only in 2012 and completed in 2013-14).
- Regarding the decision to retain internal model for CCR we must observe that:
 - 1) the adoption of a floor based on a percentage of the applicable standardised approach will disincentive investments on internal models, reducing the risk awareness deriving from the development of advanced methods;
 - 2) Note #10 on page 5 of the Consultation Paper (CP) seems to be partially in contrast to point 119 of the consultative document "Revisions to the Standardised Approach for credit risk", where the use of the SA-CCR method seems to be mandatory for collateralized OTC transactions. Given the pertinence of the possibility that CCR internal models will continue to be used, further clarification is required.

2. PARAMETER FLOORS

- In general, the floors system proposed seems to have been devised to make capital requirements more conservative. However, in order to aquire more accurate assessments, we must await the outcome of the planned simulation exercise (QIS). However, it must be said that the proposed architecture is rather elaborate and therefore, the objective of "reducing the complexity of the regulatory framework" might not be completely achieved.
- As far as low default portfolios are concerned, the shortcomings of internal models due to the absence of a large number of observations could be addressed in a more constructive manner than by the introduction of floors. Higher margins of conservatism on the raw model outcomes could be imposed, based on objective data availability and data quality measures, such as the number of default observations and loss observations. This would encourage banks to invest in data quality improvement and data pooling of credit loss data for low default portfolios. Moreover, in the current proposal, PD floors are basically envisaged for retail and corporates (with the exception of very large companies). Since default events for

these exposures are numerous, the use of floors seems both unnecessary and unduly disadvantageous.

- o With specific regard to proposed floors, we wish to point out that it is crucial to understand the methodology underlying their calibration and the review of some of these floors if we are to avoid the inconsistencies between those used in the standardised approach (i.g. for corporate with Total Assets < EUR 50bn and Annual Revenue > EUR 200m the LGD unsecured is 45% and for corporate Annual Revenue ≤ EUR 200m the LGD unsecured floor is 25%). We consider it to be necessary and appropriate for the Supervisor to analyse the results of the banks that have developed advanced models and define the percentile used to set the proposed floor. Furthermore, we need to clearly state in which cases a margin of conservatism should be avoided, or on the other hand, when it is necessary. Substantially, some simple rules should be introduced to establish how to proceed and how much conservatism to add in, in order to reduce variation in credit risk-weighted assets (both national regulators and banks use different methodologies or different margins).
- o The floor on LGD for exposures secured by receivables (15%) appears to be too conservative when the underlying portfolio is of high quality. A-IRB institution specialized in factoring and invoice finance will be highly penalized and will see significant changes in their risk appetite. We suggest to reduce significantly such floor.
- o We also wish to have some clarification on the application of the floor, namely whether it has to be applied at "single" exposure level" or at an "aggregate" level". In the former case, the new floors would imply stricter capital requirements as compared to the current regulatory framework which establishes that floors be applied at a portfolio level. Our recommendation is that floors be applied at portfolio level. Applying the floors at portfolio level rather than at exposure level would achieve the objective of avoiding perceived underestimation of risks for certain exposures types as a source of undue variation across banks. At the same time, it would preserve some risk differentiation for low risk exposures within the portfolio. As compared to an exposure level floor, this would improve incentives within banks to retain and manage low risk exposures within a portfolio.

3. PARAMETER ESTIMATION PRACTICES

a. Probability of default estimation

- o We welcome the Basel Committee proposals to limit the range of banks' practices to estimate PD. However, we must stress that there are several sources of PD variability and heterogeneity that have not been addressed in this consultation and for which a more harmonised approach would contribute to achieving the goal of reducing variability.

- o The proposals in section 4.1 potentially have significant and far-reaching implications. There are some gaps like the consideration of model philosophy and the dilemma between through-the-cycle and point-in-time models. The proposals might not be actionable in a manner that will lead to a reduction in the variability of RWA.
- o An example is already given in section 4.1, where it is proposed that PD calibration datasets have at least one year in ten of downturn data. This is a loose requirement, not representative of true downturns. A more prescriptive view of the economic cycle for PD and of the economic downturn for LGD could be considered. This would serve to promote RWA comparability through convergence in the meaning of the PD and LGD parameters.

b. LGD estimation

- o Par. 4.2.2 provides decreasing values in fixed LGD parameters for eligible non-financial collateral. In particular, the proposed new value of LGD for exposures secured by receivables is lower (20%) than the current one (35%), but at the same time the haircut is increasing from 20% to 50%. Similarly, the proposed new value of LGD for exposures secured by CRE/RRE and Other Physical Collateral are lower than the current one (respectively 20% and 25% as respect to 35% and 40%) but the haircut increases to 50%. Although a 20% LGD parameter for such collateral type appears to be appropriate, having regard to the track record of factoring operations, we believe that a 50% haircut would be too conservative and far from the actual practice, that consist in a financing facility that usually ranges from 60 to 80% of the outstanding amount of the receivables. Moreover, it could bring to unwanted consequences, pushing the institutions to reduce the amount of finance provided to the client in order to reduce the LGD parameter. That could result in a counterintuitive discouragement to increase the offer of lower risk product. At the same time, we believe that a 50% haircut for leasing exposures secured by eligible non financial collateral would be too conservative especially with respect to real estate leasing, where the value of the collateral is equal to the whole value of the exposure at the beginning of the contract and tends to remain stable during the remaining life of the lease. We suggest that the haircut for receivables and CRE/RRE should be decreased to [20-30%].
- o We wish to highlight paragraph 4.2.3 (and paragraph 4.2.4) of the Consultative Document, where the Committee proposes to apply a floor to the downturn add-on in addition to the floor on the overall LGD. We note that such a floor unduly overlaps with the general parameter floor, creating a complex framework that warrants further clarification on how these LGD floors will interact if double counting is to be avoided. In particular, we would appreciate clarification on the following:
 - ✓ regarding downturn, the document seems to consider, for the AIRB unsecured exposure (section 4.2.3), a specific estimate of Downturn parameter (as an add on component for the long-run average LGD) and, for fully and partially secured exposures (section 4.2.4), a "direct estimate" of a "downturn LGD" which have to be subject to floors (both for the secured and unsecured component)

according to the reported formula: does this mean that for fully and partially secured exposures there is no need of a specific downturn add-on because the overall "downturn LGD" is already subject to a floor?

- ✓ as for the specific estimate of Downturn parameter for the AIRB unsecured exposure (par. 4.2.3), it is described as an add-on component. We wish for clarification as to whether this indication ("sum of") must be interpreted as a specific model requirement or if, more generally, it is an indication aimed at specifying that this component should represent an increasing factor to long average LGD. Could it be estimated using different methodologies?
 - ✓ for AIRB fully and partially secured exposures, the proposed floor is calculated as a weighted average (LGD unsecured - LGD secured); should it be a methodological indication for developing LGD models "just" for secured vs. unsecured positions or does this indication only refer to the floor calculation?
 - ✓ for AIRB fully and partially secured exposures, the proposal involves the use of the same F-IRB proposed haircuts for non-financial collaterals (substantially increased); the proposed haircut applied to the value of collateral (including real estate) of 50% seems very conservative especially given the floor-approach as described in the preceding bullet point. We would like confirmation as to the correct interpretation of the proposal which may lead to undesirable consequences as its applicability by capping at the exposure value does not recognize any benefit for over-collateralization.
- Moreover, it should be noted that data samples used to estimate LGD often place a greater weighting on recession periods, so a fixed or minimum downturn value might create clear double counting. We therefore feel that the inclusion of a specific input floor on downturn LGD is inappropriate.

c. Exposure At Default and Credit Conversion Factors:

- The proposed revision of the IRB approach cannot be assessed on a stand-alone basis insofar as it would imply some asset classes being treated with the standardized approach for credit risk, whose revision is in turn ongoing. Hence, we cannot but reiterate that one of the major areas for concern for the industry is the newly proposed calibrations for CCFs, with particular reference to the 50% - 75% range currently envisaged for non-retail counterparties. A sharp increase of CCFs would result in an additional capital charge which seems unjustifiable for commitments which are unilaterally cancellable without prior notice by banks as soon as the ongoing credit monitoring process detects signs of deteriorating creditworthiness.
- Moreover, for banks which have adopted the internal model, the CCF's floor foreseen in this consultation is in any case overly conservative, especially in view of such a disadvantageous standardized approach which would be the 'base' for calculating the proposed floor.

- o This reform could bring about devastating effects on the economy. Banks would lose their incentives to grant unconditionally cancellable commitments which are, incidentally, vitally important in supporting the daily business activities of large as well as medium and small corporates.
- o Indeed as regards both F-IRB and A-IRB treatment, we are particularly concerned about the determination of the EAD for committed undrawn margins of Revolving Credit Facilities (RCFs). It should be considered that within corporate and investment banking portfolios, RCFs are normally granted as back-up facilities for supporting customer's rating needs, but they stay undrawn in most cases, with very little evidence of defaults. As a consequence, the calculation of CCFs for this type of exposure using regulatory factors that set a weight of 75% for the undrawn part will seriously hamper these activities (the observed level of CCFs and the one estimated with the internal model are much lower). Hence we must stress that the CCFs envisaged also under the internal models are overly restrictive and would have calamitous consequences on the economy.
- o A clear definition of unconditionally cancellable commitments (UCC) has not been provided and thus the diverse interpretations which have arisen in the various jurisdictions have seriously undermined the level playing field. Although we are aware that every jurisdiction has a wide array of products and transactions types which differ significantly amongst themselves and are not amenable to standardization, stricter criteria should nevertheless be defined (by drawing up guidelines, for instance). We must better identify what unconditionally cancellable commitment is (or is not) if we are to clearly distinguish the exposure cases whereby credit risk is actually close to zero in which case a more favourable treatment than the current one would be adequate. Guidelines identifying unconditionally cancellable commitments would thus ensure an enhanced risk sensitivity, allowing the 0% CCF in the standardized approach for at least those exposure categories for which credit risk is negligible. However, it would also provide for a risk sensitive CCF recalibration for the other exposures where customer protection laws and other constraints de facto prevent banks from unilaterally and immediately cancelling their commitments. As a consequence, for those banks which apply the internal model CCFs to such proved unconditionally cancellable commitments, it should be floored at 0%.
- o On unconditionally cancellable commitments (UCC), since the paper explicitly specifies that "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", this definition will have a significant impact on current practices. It should be made clear that risk limits and unadvised facilities are not commitments; likewise, there are many cases where the terms and conditions of facilities enable firms to suspend their commitments, or where the product requires bank authorisation before the client can make use of the facility.

d. Maturity estimation

- Under F-IRB, the Committee does not propose to change the fixed maturity parameter (2.5 year). We believe this fixed parameter could frustrate institutions specialized in short term finance (such as factoring and invoice finance), discouraging the investment in internal models for "standardized" institutions and at the same time unduly penalizing those that already adopted A-IRB by way of the removal of the option to use estimates stemming from their advanced models for certain exposure classes. We therefore suggest to provide, under the F-IRB approach, two buckets of regulatory fixed values for the parameter M, i.e. M = 1 year for exposures with duration up to one year and M = 2.5 year for the rest. In this regard, it's worth noting that the M parameter is an "objective" number, not subject to estimation by banks; Therefore, the adoption of our proposal would not introduce distortive effects, in contradiction with the goals of reducing the variability of the results of internal models.
- The determination of the maturity parameter explicitly prohibits the use of the repayment date of a current drawn amount. The expiry date of a facility should be used instead. We believe that truly uncommitted facilities should be excluded from this proposal since for additional drawings, or extensions, under such an uncommitted facility, explicit approval by the bank on the level of individual drawings is required and banks have the legal right to reject any such request for additional drawings. This is a common practice between banks and professional corporate counterparties

e. Credit risk mitigation estimation

- It is not clear to us how to treat substitution and guarantees. Several issues need to be resolved:
 - ✓ how would PD substitution work when the guarantor is considered as a financial institution, hence under the Standardised Approach?
 - ✓ how could the LGD be adjusted in a substitution approach?
 - ✓ how should firms treat an IRB exposure guaranteed by a Standardised Approach entity? (is it IRB or SA?)
 - ✓ how should firms check that the guarantee is only taken into account when it proves to be at a lower risk level?
- We do not agree with the proposal to remove the option to use own estimates of haircuts. Wherever reliable data is available, the ban on developing internal haircut measures seems unduly disadvantageous.

4. Other issues

Point in Time (PiT) vs Through the Cycle (TTC)

- We agree with the adoption of TTC IRB System for RWA quantification, ensuring stability of the capital requirement. This being said, we wish to point out that for some managerial uses (e.g. IFRS9, satellite models for stress testing and other managerial aspects) the PiT framework is required. Therefore, strict constraints in using a TTC approach could lead to some divergences in risk management practices.