

March 27, 2015

Comments on the Basel Committee on Banking Supervision's Consultative Document
*"Revisions to the Standardised Approach for credit risk issued by the Basel Committee on
Banking Supervision"*

Japanese Bankers Association

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on the *Consultative Document: Revisions to the Standardised Approach for credit risk* issued by the Basel Committee on Banking Supervision (the BCBS).

We respectfully expect that the following comments will contribute to your further discussion.

<<1: General Comments>>

(1) Impacts of these Revisions

The revisions to the standardised approach (SA) for credit risk proposed in this Consultative Document may have impacts on the risk-weighted asset (RWA) calculation method employed by all banks including small-sized banks, and even on the real economy through a material change in individual banks' portfolios and modification of their business model, depending on the revisions. Possible negative impacts include a concern of procyclicality in that a decline in financial institutions' credit extension ability as a result of an increase in their capital requirements in times of economic downturn would deepen the economic slowdown; and the application of a risk weight calculation method based on risk drivers (i) would incentivise borrowers to show such risk driver indicators better and (ii) undermine sound lending practice of the lenders. In addition, the risk measurement methodologies proposed in this Consultative Document are not necessarily appropriate in terms of risk sensitivity, as discussed in the Specific Comments section below. Consequently, re-consideration should be made through the implementation of the second consultation based on more extensive feedback, including the comments provided in this comment letter.

(2) Adequate calibration

Risk weights under the revised SA approach should be sufficiently verified and calibrated through a quantitative impact study (QIS) so as not to drastically raise the level of the risk weights relative to the current level. The risk weights proposed at this stage are generally higher for main exposures including banks, corporates, equities and residential real estate. Implementing risk weights as proposed would give rise to a substantial increase in

capital charge. Consequently, there is a concern that this may cause credit crunch, for example, prompting banks to collect their loans from small and medium-sized entities (SMEs) with a higher risk weight. With regard to the proposed level, therefore, it is requested for BCBS to demonstrate data supported by analysis.

Further, in finalising the calibration of risk weights, if the proposed treatment to use the SA approach as a floor for banks using the IRB approach would be implemented, calibration for floors should be established in a manner to avoid situations where banks would result in breaching the floor despite they are calculating risk-weighted assets using an appropriate internal ratings-based (IRB) approach (i.e. cases where risk-weighted assets are not being underestimated). In such case, deliberate discussions taking into account the impact of the floor are required as to how a floor should be established and what should be the “adequate level” of a floor, after thoroughly comparing average risk weights under the IRB approach or historical allowance rates and loss rates across financial institutions and jurisdictions,.

(3) Implementation of lead time and transitional arrangement

In introducing the revised standardised approach, a sufficient lead time and an appropriate transitional arrangement should be implemented. A sufficient lead time should be ensured after its finalisation, taking into account that systems development and modification to collect and calculate data on new risk drivers require certain period of time and that the revisions have a significant impact on small-sized financial institutions which may have some difficulties in complying with the revised framework. Further, appropriate transitional arrangement, such as exclusion of existing credit exposures, is needed, given an effect of a sharp increase in the level of capital requirement on financial institutions’ behaviour and an impact on existing credit exposures whose risk drivers are difficult to be obtained.

(4) Use of external ratings

This Consultative Document questions mechanistic reliance on external ratings and proposes to reduce such reliance. In fact, excessive reliance on external ratings in identifying risks of securitized products might have led to expansion of the financial crisis. On the other hand, external ratings for financial institutions and corporates that are granted using many disclosed information and used as part of credit risk assessment for financial institutions and corporates are considered to have certain reliability, and hence reasonable to include these ratings in the calculation of regulatory capital.

Additionally, a method for calculating risk weights according to the matrix based on two risk drivers for exposures to banks and corporates proposed in this Consultative Document does not appropriately reflect high creditworthiness of banks and corporates with high credit standing.

We therefore suggest that, for exposures to banks and corporates, risk weights referencing the external rating should be assigned to obligors with external ratings, while risk

weights using the matrix based on the two risk drivers should be apply to obligors with no external rating, as stated in specific comments. In addition, it is suggested to also take certain measures to enhance the eligibility criteria for credit rating agencies to improve external ratings' reliability, in order to ensure the adequacy of reliance on external ratings.

(5) Local calibration

Since many of firms that directly use the SA approach are relatively small-sized financial institutions rooted in respective regions of jurisdictions, it is necessary to give due consideration to impacts on these financial institutions and on financial systems in respective regions and jurisdictions.

Financial institutions have developed their own business models under respective law regime and financial economy/market environment that vary across jurisdictions. Requiring financial institutions to apply a uniform approach may have an unexpected and a huge impact on financial institutions in certain jurisdictions and unstabilise regional financial systems. For example, residential loan markets vary in nature across jurisdictions. Some markets, including Japan, focus on borrowers' ability to repay a loan and other markets focus on collateral value. It is not considered appropriate to ignore such difference and introduce a uniform approach.

We therefore suggest a framework permitting local calibration in relation to risk weights under certain conditions, for example, cases where the application of uniform risk weights has a significant impact on domestic financial institutions and financial systems.

<<2: Specific comments and our responses to the questions>>

1. Exposure to banks

Our responses to the questions

Q1. What are respondents' views on the selection of the capital adequacy ratio? In particular, is the CET1 ratio superior to the Tier 1 ratio or the Leverage ratio? Do respondents agree that it is necessary to require calculations in accordance with Basel III in order to ensure a consistent implementation?

We support the use of the Basel III capital adequacy ratio.

However, a measure which is readily available should be used as an element to determine risk weights. Banks in the jurisdictions that have not yet implemented Basel III do not calculate the CET1 ratio, while not all financial institutions in the jurisdictions that have already implemented disclose this ratio. It is therefore proposed to use the "total capital adequacy ratio" which is more readily available as an alternative measure.

Q2. Do respondents believe the net NPA ratio is an effective measure for distinguishing a bank exposure's credit risk? What alternative asset quality measure, if any, should be considered by the Committee?

As with the CET1 ratio, the net NPA ratio is not necessarily disclosed by all banks and is not readily available. In addition, the definition of default varies across jurisdictions and hence the net NPA ratio is not appropriate in terms of comparability. It is suggested that, for example, a readily-available measure "allowance for credit losses/total assets in balance sheet" be used. Even in this case, it should be noted that the definition varies across jurisdictions. In addition, it is desirable to carry out quantitative analysis based on QIS.

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

We concur with the treatment of lowering a risk weight assigned to short-term interbank claims. However, it is considered to be more appropriate to define the application criterion as one year or less, not three months or less of original maturity, and not to set a risk weight floor, for the following reasons:

(1) Reason for the application criterion of one year or less

We understand that, under the current IRB approach, a 1 year floor is generally applied to maturity, while for certain interbank transactions, a floor is not set and a 1 year is employed as a threshold when short-term claims for banks are exceptionally treated. Accordingly, it is considered appropriate to ensure consistency of buckets between the SA approach and the IRB approach.

Further, a threshold typically used to distinguish long term and short term is one year and this is consistent with the accounting and practical treatment of financial institutions.

(2) Reason for appropriateness for not setting a floor

Risk weights of credit exposures for banks based on actual data under certain member bank's IRB approach are as shown in the table below according to maturity, and are largely different from the proposed floor of 30%. Setting a floor does not therefore reflect an actual state.

Period	3 months	6 months	1 year	(Ref) 2.5 years
RW	7.1%	7.4%	7.8%	11.6%

Also, this rule should explicitly define that liquid deposits such as "Current deposits", "Ordinary deposits" and "Due from foreign banks (our current account)" may be treated as short-term claims.

Q4. Do respondents have suggestions on how to address these concerns on the treatment of exposures to banks? In particular, do respondents have views on how to treat exposures to banks not subject to Basel III in a consistent and risk-sensitive manner?

We suggest calculating risk weights by reference to external ratings for obligors with external ratings and by using the matrix based on risk drivers, as proposed in the responses to Q1 and Q2, only for obligors with no external ratings.

External ratings reflect benchmarks specific to financial institutions, such as Common Equity Tier 1 (CET1), a net non-performing loan ratio, profitability indicators, leverage, liquidity, a loan-deposit ratio, involvement in governance by government, domestic share, regulatory developments, and the nature of business, and thus are believed to have certain reliability. However, under an approach to calculate risk weights by employing two risk drivers, as proposed in this Consultative Document, risk weights do not completely reflect high creditworthiness of especially an obligor group with high credit standing and therefore should not prevail over external ratings.

Assigning a punitive risk weight of 300% to a bank that has not yet adopted Basel III or has not published relevant information under disclosure requirements should be avoided because it does not reflect actual risks and may have an adverse impact on the real economy through contraction in the interbank market.

Other requests and comments

(1) Level of risk weights

Risk weights under the revised SA approach range from 30 to 300%, but proposes to set the range from 20% to 150%, same with current SA approach through QIS, along with the preferential treatment for those exposures having an original maturity of one year or less being treated as short-term claims, as suggest in the response to Q3.

(2) Treatment of exposures to securities firms and other financial institutions

Under the treatments envisaged in this Consultative Document, if exposures to securities firms and other financial institutions are subject to prudential standards and the risk drivers are disclosed, such exposures are treated in the same manner as banks, and if not, the exposures are treated in the same manner as corporates. These treatments should be re-considered for the following reasons:

If the determination of using either CET1 and net NPA ratios, or revenue and leverage is dependent on whether an counterparty is subject to prudential standards and whether risk drivers are disclosed, inconsistent risk weight calculation will be defined for one business category “securities firms”, and this is not an appropriate framework. It is also doubtful whether such risk drivers are reasonable for exposures to securities firms and other financial

institutions and whether it is appropriate to require those institutions to disclose the CET1 and net NPA ratios based on Basel III.

(3) Other requests and comments for exposures to banks are described below:

- (i) The treatment to require use of solo-based ratios of the legal entity against which the exposure is held in preference to consolidated level ratios should be avoided because the current treatment under the IRB approach uses the consolidated financial statements to determine which large-sized financial institutions are subject to a higher risk weight, and hence this treatment is not consistent with the IRB approach; many banks form a consolidated group and a solo basis may largely differ from a consolidated basis; and a determination on whether to use either solo or consolidated basis based on availability may provide an arbitrary opportunity.
- (ii) It is requested to clarify whether the referenced CET1 ratio (or total capital adequacy ratio as suggested in this comment letter as an alternative measure) is applied either on a transitional arrangement or full implementation basis.

2. Exposures to corporates

Our responses to the questions

Q5. Do respondents have views on the selection of risk drivers and their definition, in particular as regards leverage and the incorporation of off-balance sheet exposures within the ratio? Would other risk drivers better reflect the credit risk of corporate exposures?

We suggest calculating risk weights by reference to external ratings for obligors with external ratings and using the matrix based on risk drivers only for obligors with no external ratings.

External ratings reflect profitability indicators, leverage, liquidity, parent company's creditworthiness, domestic share, and the nature of business, and thus are believed to have certain reliability. However, under an approach to calculate risk weights by employing two risk drivers, as proposed in this Consultative Document, risk weights do not completely reflect high creditworthiness of particularly an obligor group with high credit standing. For example, the proposed minimum risk weight of 60% corresponds to a risk weight for a borrower with PD of approximately 0.36% under the IRB approach, assuming a loss given default (LGD) of 45% and maturity of 2.5 years. This PD is equivalent to the probability of default (PD) for a borrower with S&P BB to BBB ratings and hence is not considered to sufficiently reflect the creditworthiness of a borrower with investment grade or higher.

Possible issues with the proposed two risk drivers are as discussed below. To address these issues, the BCBS is requested to provide the rationale for the selected risk drivers as well to discuss various alternative approaches.

(1) Revenue

- (i) Risk weights for SMEs and early-stage enterprises will be higher and there may be an adverse impact on credit creation function of a bank and on financing by good-standing SMEs. SMEs accounts for 99.7% of all entities in Japan. 95.6% of SMEs and almost all of sole proprietors demonstrate revenue of JPY 0.5 billion or less. The revenue buckets proposed under this Consultative Document that treat this type of entities together as one type of entities and assign a higher risk weight than the current 100% is not considered to appropriately reflect risks of such entities. For details, see the response to Q6.
- (ii) It is understood that revenue is selected as an indicator to reflect a size, but it has a disadvantage that it does not represent profitability of an entity, particularly in the case where an entity demonstrating negative earnings does not result in negative assessment.

(2) Leverage

- (i) It is understood that leverage is selected as a metric to measure financial soundness, but the fact that the level of leverage may significantly differ depending on industry features is not considered. As a consequence, with respect to industries with a low default rate but a high leverage due to their industry characteristics, such as railway and electricity, a risk weight may be unduly raised. A sales finance company of manufacturing industry and a group finance company also have a high leverage. However, such companies should be assessed based on their parent company's creditworthiness by deeming that their business and their parent company's business are substantially united. Consequently, evaluation of leverage on a solo basis would underestimate the actual creditworthiness.
- (ii) We oppose to the inclusion of off-balance sheet exposures since accounting practices and disclosure standards vary across jurisdictions, thereby expanding variation in measurement outcome and increasing the complexity of measurement.

Additionally, if the figures reported in financial statements are generally treated as risk drivers, there are following concerns: differences in accounting and taxation system across jurisdictions are reflected in risk weights; industry characteristics are not reflected in risk weights; and this may become a factor causing fraudulent accounting of unlisted entities.

Q6. Do respondents have views on the appropriateness of the proposed treatment, especially with regard to SMEs? And about the more lenient treatment for start-up companies?

Under the SA approach that is less risk-sensitive, there may exist a situation whereby a risk is deemed to be high for regulatory purposes although a bank determines a risk to be low. In this case, capital regulation takes precedence over the bank's determination. In particular, in cases where an indicator of size, such as "revenue", is deemed as a risk driver, it may have

an adverse impact on loans to prudent SMEs that underpins the real economy. We therefore strongly suggest assigning a lower risk weight to SMEs, considering factors shown below.

- (1) A credit portfolio comprising of small-sized borrowers, primarily SMEs, has dispersion effect, with lower correlation with systemic risk factors as taken into account under the IRB framework. Thus, a risk weight of such portfolio as a whole would be at a lower level:
- (2) Generally, the percentage of loans for SMEs secured by collateral is high. At some member banks, the LGD of exposures to SMEs is approximately 10% lower than that of exposures to corporates, and therefore exposures to SMEs tends to be more secured. The effect of collateral however is not reflected in the matrix based on two risk drivers.
- (3) SMEs have limited funding tools and depend heavily on loans from banks. If the above is not taken into account, and a lower risk weight is not applied to SMEs, smooth funds supply by banks to SMEs will be inhibited and there may be an adverse impact on the overall real economy.

Besides SMEs and early-stage entities, there exist entities whose financial information cannot be acquired easily, such as obligors of purchased receivable, small lease receivables, entities issuing public and corporate bonds, and underlying assets of a fund, as well as entities to which risk drivers similar to corporates do not suit, such as non-profit organizations, trusts, associations and schools. It is not appropriate to use one matrix in a uniform manner to determine risk weights for such entities. In particular, assigning a 300% risk weight because of unavailability of such entities' financial information lacks an appropriate balance in light of risk sensitivity. This assignment may undermine the financial intermediary function and therefore should be avoided.

Q7. Do respondents think that the risk sensitivity of the proposal can be further increased without introducing excessive complexity?

For measuring corporate exposures, simplicity and risk sensitivity is in a trade-off relation and therefore it is difficult to enhance risk sensitivity without increasing simplicity. This comment letter proposes to strengthen risk sensitivity by calculating risk weights using external ratings first if external rating are available and the matrix based on risk drivers only if not.

Q8. Do respondents agree that introducing the specialised lending category enhances the risk sensitivity of the standardised approach and its alignment with IRB?

We agree with introducing the specialised lending category, but oppose to the use of the same risk drivers as corporate exposures to determine risk weights for specialised lending.

Since specialised lending is a claim backed by cash flows, which differs from the corporate exposure where “going concern” is assumed. Thus using “revenue” and “leverage” to measure credit risk does not reflect actual state. Therefore, either measures typically used in the financial institutions’ practice, such as LTV and DSCR, or a risk weight of 100% under the current SA approach should be applied.

Other requests and comments

(1) Level of risk weights

Consideration should be made to ensure that the risk weights for exposures to corporates are within the range (20-150%) of the risk weights under the current SA approach. We understand that this Consultative Document does not intend to raise overall capital requirements under the SA approach, but are concerned that the proposed treatments may sharply raise the level of capital charge (for example, the amount of RWA will increase about 1.3 times based on the estimation made using the database that primarily covers banks using the standardised approach), and credit contraction may have an adverse impact on real economy. Further, where a floor under the SA approach is applied at a level that exceeds risk assets under the IRB approach, it may weaken risk management activities, for example, banks may make credit decisions solely on the basis of revenue and leverage.

Also, assigning a 300% risk weight to cases where data necessary to calculate revenue and leverage which are risk drivers for corporates is not available should be reconsidered because the 300% risk weight is the same level as borrowers with negative equity and is excessively conservative.

(2) Risk weights for entities with negative equity

Uniformly applying a 300% risk weight to all borrowers with negative equity is excessively conservative, compared with a 150% risk weight for borrowers in delinquency under the current SA approach. The appropriate treatment would be to, for example, assign a lower risk weight for a borrower that demonstrates net profit despite being in negative equity than a borrower that incurs net loss.

3. Subordinated debt and equity exposures

Requests

(1) Risk weights for subordinated debt

Uniform application of a 250% risk weight is not considered to be reasonable, and hence a risk weight that reflects each credit risk for each borrower should be applied. It is proposed to determine risk weights by using risk weights for corporate exposures reflecting a difference in the LGD between subordinated and unsubordinated debts.

Unreasonableness of the revised SA approach proposed (a 250% risk weight for subordinated debt

This proposal applies a similar requirement set out in treatment of significant investments in the common shares of unconsolidated financial institutions (capital deduction or 250%)” (only application of 250%) under Basel III.

The treatment of significant investments in the common shares of unconsolidated financial institutions aims to prevent unstabilization of financial systems due to double gearing. It is therefore unreasonable to apply this treatment to corporate exposures.

Proposal on lowering risk weights

In reflecting credit risk, given that subordinated debt is subordinated to unsubordinated debt in respect of collection, it is reasonable to determine risk weights by using risk weight for corporate exposure reflecting a difference in LGD between subordinated and unsubordinated debts. Specifically, supervisory LGD ratios under the foundation internal ratings-based approach (FIRB) are 75% and 45% for subordinated and unsubordinated debts, respectively. Consequently, it is suggested to set a risk weight for subordinated debt at 1.67 times of corporate exposures for subordinated debt ($=75\% / 45\%$) by using these ratios.

(2) Risk weights for equity

A risk weight based on “credit risk” should be applied to equity that meets the definition set out in Basel II paragraph 352, differentiating from equity investments which are expected to generate capital gains.

It is proposed to define risk weights based on credit risk by using risk weight for corporate exposures reflecting a difference in the LGD between equity and unsubordinated debt in risk weights.

Equity held for a long term with no anticipation of capital gains totally differs in nature and underlying risk from equity investment with expectation for capital gain.

Therefore, in calculating RWAs for equity held for a long term, a risk weight reflecting credit risk, not price risk, should be applied.

Unreasonableness of the revised SA approach proposed (300% and 400% risk weights for listed and unlisted equities, respectively

This Consultative Document proposes risk weights which are calculated according to “price risk” used by the simple market-based approach under Basel II internal rating-based approach. Basel Rule (Revised Text paragraph 352) permits risk weights for equity held for a long term, to be calculated in a manner different from equity investment for other purposes. Therefore, which risk should be focused on varies depending on the nature of investment. In determining the value of equity held for purposes of a short-term sale, it is appropriate to apply a risk weight that focuses on price risk because movements in the overall market has

more impact than issuer’s creditworthiness. On the other hand, with regard to equity held for a long term, it is more appropriate to determine a risk weight by focusing on issuer’s credit risk rather than price risk because the determination of the value would be largely affected by the issuer’s creditworthiness rather than short-term movements in the market.

Proposal on risk weights based on credit risk

In reflecting credit risk, given that equity is subordinated to unsubordinated debt in respect of collection, it is reasonable to determine risk weights by using risk weight for corporate exposure reflecting a difference in LGD between equity and unsubordinated debt. Specifically, supervisory LGD ratios under the foundation internal ratings-based approach (FIRB) are 90% and 45% for equity and unsubordinated debt, respectively. Using these ratios, it is suggested to set a risk weight at 2 times of corporate exposures (=90% / 45%).

However, price fluctuation risk may exist in equity held for a long term. To reflect this, it is considered reasonable to also set a certain floor for a risk weight of equity held of a long term.

(3) Treatment of ETFs

The types of products invested by ETFs range widely, such as equity, bond and loan. In addition to treating ETFs as listed equity, we would like to confirm whether the look-through approach be applied by treating ETFs as a fund.

4. Retail exposures

Our response to the question

Q9. Can respondents suggest, and provide evidence on, how to increase the risk sensitivity of the regulatory retail exposures treatment, either by differentiating certain product subcategories for which a specific risk weight may be appropriate; or by suggesting simple risk drivers that could be used to assess the risk of all retail exposures?

Retail exposures incur from mass products, and hence it is impracticable to identify respective borrowers’ creditworthiness. Therefore, there would be no issue in uniformly applying 75% risk weight under the current SA approach. However, if 10% CCF is uniformly allocated to unconditional cancellable commitments, it is proposed to apply a lower risk weight to the balance of undrawn line of credit cards (and card loans), because since there are many inactive credit cards (and card loans) and probability of default (PD) for those holders is extremely low, it is reasonable to assign a lower risk weight.

5. Exposures secured by residential real estates

Our responses to the questions

Q10. Do respondents agree that LTV and/or DSC ratios (as defined in Annex 1 paragraphs 40 and 41) have sufficient predictive power of loan default and/or loss incurred for exposures secured on residential real estate?

In general terms, we support that LTV and DSC ratios are useful as indicators to measure credit risk.

However, the following comments should be noted.

Regional differences in real estate markets and lending practice should be considered. That is, different treatments should be considered for recourse loans that focus on the borrowers' ability to repay a loan (typical in a jurisdiction where purchase of new property is particularly preferred and liquidity of used property is not high, as with Japan) and non-recourse loans that are dependent on collateral value.

With regard to recourse loans that require borrowers to repay debts, the significance of collateral value in determining the soundness of claims is relatively low than non-recourse loans, and the LTV is higher than that of non-recourse loans. Further, the DSC ratio is considered to be more important. Considering such product characteristics, two types of risk weights tables should be set separately for recourse and non-recourse loans. In addition, the DSC ratios of 35% or less should be sub-divided to apply a lower risk weight to an exposure with a low DSC ratio.

Q11. Do respondents have views about the measurement of the LTV and DSC ratios? (In particular, as regards keeping the value of the property constant as measured at origination in the calculation of the LTV ratio; and not updating the DSC ratio over time.)

With regard to income constituting the DSC ratio, the use of data before tax should be allowed. Even if a tax burden rate is the same, the level of income after tax would be higher in a jurisdiction that primarily applies indirect taxes than in a jurisdiction that primarily applies direct taxes. Annual income before tax, not after tax, should therefore be used to uniformly measure the borrowers' ability to pay loans beyond jurisdictions. Further, the definition of concept of after tax is unclear (i.e. whether it covers national taxes, local taxes, social insurance or premiums).

Q12. Do respondents have views on whether the use of a fixed threshold for the DSC ratio is an appropriate way for differentiating risks and ensuring comparability across jurisdictions? If not, what reasonably simple alternatives or modifications would respondents propose while maintaining consistent outcomes?

The proposed thresholds are lacking balance because LTV has 6 buckets, while DSC has only 2 buckets. The threshold of the latter is at a higher level of 35%, and therefore does not reflect lower risk profile of high income borrowers. Accordingly, the DSC buckets should be subdivided into 4 or 5 to reduce the level of risk weights for borrowers with a lower DSC.

Q13. Do respondents propose any alternative/additional risk drivers for the Committee's consideration in order to improve the risk sensitivity in this approach without unduly increasing complexity?

(No comments)

Other requests and comments

(1) Level of risk weights

With regard to risk weights of exposures collateralised by residential real estate, the category that receives 80% to 100% risk weights should receive risk weights of 75% or lower which is the current risk weight of retail exposures for the following reason:

We understand that this Consultative Document does not intend to raise overall capital requirements under the SA approach, but 35% will be changed to 25% - 80% (average: 47.5%, medium: 45%) for the LTV of 100% or lower, and 75% will be changed to 80% - 100% for the LTV of more than 100%, which will lead to an increase in capital charge.

6. Exposures secured by commercial real estate

Our responses to the questions

Q14. Which of the two options above is viewed as the most suitable for determining the risk-weight treatment for exposures secured on commercial real estate?

Q15. What other options might prudently increase the risk sensitivity of the commercial real estate treatment without unduly increasing complexity?

We basically support the option A. Even in the case of credit exposures for commercial real estate, a recourse loan can require borrowers to repay and source of loan collection does not rely solely on the value of real estate pledged as collateral. Accordingly, the determination of risk weights using the LTV should be limited to non-recourse loan. Similarly to exposures to corporates, recourse loans should receive a risk weight for counterparties, instead of treating it as an independent bucket. However, risk mitigation effect of collateral should be

reflected.

7. Risk weight add-on for exposures with currency mismatch

Our responses to the questions

Q16. Do respondents agree that a risk weight add-on should be applied to only retail exposures and exposures secured by residential real estate? What are other options for addressing this risk in a simple manner?

Since the application of a currency risk add-on only to retail exposures lack fairness, a risk weight add-on for exposures with currency mismatch is not considered necessary.

8. Off-balance sheet exposures

Our responses to the questions

Q17. Do respondents consider the categories for which a CCF is applied under the standardised approach to be adequately defined?

CCFs for commitments differ between the current SA and the FIRB approach and therefore we support aligning the CCFs applied under SA with those applied under the FIRB approach. On the other hand, this gives rise to a one-sided increase in the CCFs (20%, 50%→75%) and therefore the level of CCFs both under the SA and FIRB approaches should be calibrated through QIS, instead of applying a 75% CCF.

Q18. Do respondents agree that instruments allocated to each of the CCF categories share a similar probability of being drawn and that the probabilities implied by the CCFs are accurate? Please provide empirical support for your response.

(1) Unconditional cancellable commitments

Assigning a 10% CCF to unconditional cancellable commitments is excessively conservative and it is requested to consider a reduction in the CCF. In particular, we propose that the CCF for retail commitments pertaining to credit card products should be 0.7% based on actual usage data. If the CCF is uniformly set at 10%, the current 75% risk weight applied to all retail exposures should be revised to ensure that risk weights vary depending on risk characteristics of exposures; for example, applying a lower risk weight to a card having no usage records.

Rationale for proposing a lower CCF of 0.7%

Recent 2 years usage data for credit card products issued by certain JBA's member bank (at the end of each month) shows that the minimum drawn rate of credit lines is 5.73% while the maximum rate is 6.35%. The difference between the minimum and maximum rates is only

0.62%, which is considered to be very small. The rate of this difference (0.62%) to the ratio of unused commitment (94.27% of total credit extension) for the minimum rate is 0.66% ($=0.62\%/94.27\%$), which is equivalent to the maximum range of additional drawn rate arising from the amount of undrawn commitment for credit card products. It is therefore proposed to select this as the CCF.

Rationale for proposing a lower risk weight in case of applying a 10% CCF uniformly

The CCFs under the IRB approach represent an additional draw-down rate in the event that a borrower becomes default and risk weights are determined by reflecting the PDs of respective borrowers. Under the IRB approach, therefore, if the same CCF is applied to the undrawn amount of all commitments, risk weights are adjusted according to borrowers' credit risk. For example, if both borrowers with higher credit standing and lower credit standing receive the same CCF, this treatment would result in the same amount of exposures for these borrowers. However, a risk weight for borrowers with higher credit standing should be lower while that for borrowers with lower credit standing be higher.

On the other hand, under the SA approach, a risk weight of retail exposures is fixed at 75% and does not reflect borrowers' PDs. In other words, the amount of undrawn commitments for both borrowers with higher credit standing and lower credit standing would result in the same amount of risk-weighted assets.

With regard to credit cards, which is a product targeting a mass market, it is difficult to identify respective borrowers' creditworthiness after issuing cards. It is however possible to allow a certain difference in setting risk weights, assuming reasonable differences in PDs taking into account the conditions of transactions.

Actual data for credit card products issued by certain JBA's member bank shows that approximately 30% of total credit extension to the cards issued by this bank is inactive, i.e. no usage records. PDs of such inactive card holders would be significantly lower than that of the active card holders. However, as described above, the difference between the two is reflected in risk weights under the IRB approach but is not under the SA approach. Since this is not considered to be reasonable treatment, different risk weights should be assigned for credit cards, depending on the usage and non-usage of the cards.

(2) Normal commitments

Uniform application of a 75% CCF to normal commitments is excessively conservative. It is therefore proposed to apply a 60% CCF. The proposed CCF of 75% is a ratio applied based on the draw-down rates at default under the foundation internal ratings-based approach (FIRB). Hence, assigning 75% to the undrawn line is believed to be excessive. On the other hand, a 60% CCF is considered to be appropriate, based on the result of analysis that certain member bank's estimation of the CCFs under the advanced internal rating-based approach (AIRB) was within the range of upper 50%.

9. Others

Response to the questions

Q19. What are respondents' views on the alternative treatments currently envisaged for past-due loans?

Under the current treatment, a risk weight higher than performing loans is applied, taking into account cases where the amount of specific provisions is deemed appropriate. Therefore, there is no particular issue for this point.

Q20. Do respondents agree with the proposed treatment for MDBs?

(No comments)

Q21. What exposures would be classified under "Other assets"? Is a 100% risk weight appropriate? (Please provide evidence where possible).

In addition to assets recorded in "other assets" for an accounting purpose, "property plant and equipment" is primarily classified under "Other assets".

These assets mainly represent property, not claims, and have no borrowers. Risk weights cannot therefore be determined based on borrowers' credit risk. However, these assets are also inherent to a risk of incurring losses due to damage. Although this risk is different from credit risk, it is reasonable to apply a 100% risk weight which means a risk weight requiring capital surplus to maintain 8%, a minimum capital ratio achieved by banks subject to international standards in relation to their assets held.

Q22. What are respondents' views on the above alternative ways to define eligible financial collateral?

(No comments)

Q23. What are respondents' views on the recalibrated supervisory haircuts shown in Table 4? What are respondents' views on how to eliminate references to ratings from the supervisory haircuts table? What could be the implications of eliminating references to external ratings?

Given that external ratings of corporates and banks are robustly determined compared with those previously assigned for securitised products, references to external ratings which are an indicator superior in terms of simplicity and risk sensitivity should not be eliminated.

Q24. What are respondents' views on the proposed corporate guarantor eligibility criteria?
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ECA (export credit agency) finance and similar products do not strictly fall under the category of sovereigns, but may be deemed as public guarantees. They therefore should be treated as eligible guarantee.

10. Other comments and requests from an overall perspective

(1) Impact on other regulations

Under the net stable funding ratio (NSFR), a lower required stable funding (RSF) is assigned to loans that qualify for a 35% or lower risk weight under the SA approach for credit risk. Since the NSFR figures will be changed being linked with the revision of SA for credit risk, careful consideration is considered necessary.

(2) Since exposures to which the exception for banks using the IRB approach are applied are those with immaterial risk-weighted assets, a simplified treatment should be permitted by, for example, assigning a 100% risk weight to all exposures to corporates.

(3) In finalising this rule, it is requested to clarify:

- Whether differences in accounting standards can be accepted as-is.
- Which ratio should be used for exposures for corporates, consolidated or solo basis.