KOREA FEDERATION OF BANKS

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KFB comments on Revisions to the Standardised Approach for credit risk

The Korea Federation of Banks (KFB) is a bankers' association that represents and promotes the interests of the Korean banking industry as a whole. Our membership comprises banks both domestic and international, operating in Korea.

The Korea Federation of Banks has collected, and hereby submits Korean banks' views on the Revisions to the Standardised Approach for credit risk announced by BCBS on December 22, 2014. This document points out some issues of the consultative paper and suggests recommendations reflecting the current situation in Korea after consulting with Korean banks.

□ Exposures to Banks

① Difficulty in obtaining banks' capital adequacy data

◦ The fact that there are banks that do not officially disclose relevant data on overseas banks (branches included) results to difficulties in periodic collection of Common Equity Tier 1 (CET1) ratio and net non-performing assets (NPA) ratio of all banks with which individual banks engage in cross-border trade. The absence of the relevant information results in the application of risk weighting of 300% and we believe this is excessive compared to the current risk weighting of 100% applied to unrated banks. In addition, for cross-border trade transactions, banks do business with multiple overseas banks and when it is difficult to obtain the data of the counterparties, they avoid engaging in trade transactions with small banks or request additional reviews from large banks. This may result in cross-border trade transactions changing to revolve around banks with a global presence.

◦ Therefore, an institution that periodically compiles and provides CET1 and Net NPA ratios for banks around the globe (including branches) is necessary. In addition, considering that banks undergo regulation on capital adequacy from each country's financial regulators, we request a more lenient risk weighting than the proposed revisions.

② Clear Definition Criteria for NPA Necessary

◦ Given the point in time of default recognition and interpretation of NPA may vary depending on the country, there is a necessity for consistent definitions among countries by defining the clear criteria for point in time of default recognition, other credit exposure and other assets to capital adequacy.

③ Lack of consistency of applied indexes

◦ Regarding the BCBS large exposure framework, the standard of ceiling calculation has been changed from common equity Tier 1 (CET1) capital to Tier 1 capital (Banks in the form of unions without common equity cannot calculate the CET1 ratio). As such, applying the Tier 1 capital ratio is more suitable than CET1 ratio as the criteria for evaluating capital adequacy for exposures to banks.

□ Exposures to Corporates

① Excessive risk weighting (300%) for companies without financial statement disclosure

◦ For the following cases, obtaining financial statements is realistically not feasible and require supplementation.

· Some multinational corporations and their affiliates do not submit their financial statements as part of their company policy or in working practices.

· Some collective investment vehicles for certain derivative products (hedge transactions for derivatives of investment trust-type funds) do not provide separate financial statements for each fund.

· Religious organizations and non-profit companies have almost no financial statements.

◦ Therefore a reduction of risk weighting and expansion of financial statement use* for companies which do not provide financial statements are necessary.

* In cases where obtaining financial statement of the previous year is difficult, using financial statements of the year before the previous year should be permitted.

② Leverage and revenue use

◦ Corporate exposure applies risk weighting that differ depending on just leverage and revenue amounts. Accordingly, there is the likelihood of excessive risk weighting being applied than actual risk levels for obligor companies with high leverage due to the nature of their industries, including airlines, shipbuilding, and oil refining.

◦ Also, it has an irrational aspect of applying risk weighting of 100% and over on small companies due to the fact that their currently realizing revenue are relatively small in spite of being excellent in profitability and growth potential. Therefore, it is necessary to revise the risk driver to better reflect the characteristics of industries and company size.

③ Separate risk weighting for equities issued by public enterprises necessary

◦ Equity which public enterprises etc with low risk weighting due to being able to offset losses from government help or due to high share holdings of the government have less LGD when defaulting on liabilities unlike ordinary corporates. Therefore it is rational to apply a relatively low risk weighting.

◦ The current IRB has exceptions which provide differentiation to allow a separate risk weighting for national discretion regarding equity of obligors on which low risk weighting is applied using the standardized provisions. `

* Basel Ⅲ rules text, June 2006, 「International Convergence of Capital Measurement and Capital Standards」356 clause (iii) Exclusions to the market-based and PD/LGD approaches

□ Exposures Secured by Residential Real Estate

◦ The Debt-to-Income Ratio (DTI), which is the regulation for household loans used by Korean financial regulators, confirms indicators based on pre-tax income.* Therefore it is difficult to maintain consistency of the indexes and regulations in the revisions which define ability to repay based on after-tax income.

* Income certificate in Korea is issued on the basis of pre-tax income

◦ The revisions require using the purchase price of residential real estate to calculate LTV, but it is rational to evaluate using standard market price rather than purchase price for residential real estate collateral which is being renewed to service loans already granted.

◦ Therefore, the regulators of each country should, in accordance with Pillar 2, consider the risk levels and allow for national regulators' discretion to apply suitable risk weighting.

☐ Specialized Lending

◦ For specialized lending, there is concern that a high risk weighting will be applied to obligors that have relatively high leverage and without financial statements (ie taking time until sales are generated). Therefore, for specialized lending, we propose review of applying risk weighting tables that are different from exposure to corporates or raising the certain ratio of risk weighting which is currently applied, to simplify the application method.

☐ Off-balance CCF

◦ To align standards with the IRB approach, we agree that it is necessary to revise our regulations. However, Korean banks that use almost no cancellable commitments for unused credit ceilings have been analyzed as having a large impact on an increase in RWA owing to CCF changes. Therefore, it could give rise to negative side effects including reduction in unused commitment reductions for counterparties including for SMEs, more stringent credit reviews and reviews each time additional transactions are requested.

◦ Therefore, we request separated application depending on the period of CCF for unused commitments.*

* e.g.) Short-term CCF 20% → 30%, Long-term unused commitments CCF 50% → 75%

※ Conclusion

◦ The introduction of Basel III has significantly strengthened BIS ratio regulatory levels. In this context according to these revisions from the Basel Committee, we predict RWA will increase substantially and for domestic banks, BIS ratio will decline to 1%-3%p.

◦ Korean banks, which are experiencing a downtrend in profitability, will focus on liquid assets and capital enhancement to meet BIS ratio requirements, and we are concerned that their weakened ability for marketing and lending may have a negative effect on supporting the real economy.

◦ Therefore, we believe it is necessary to review parts in the revisions which substantially impact the increase in RWA and maintain current regulations or phasing in the revisions.

Thank you for providing the opportunity to industry stakeholders to comment on BCBS's *"Revisions to the Standardised Approach for credit risk"* The KFB and its members shall continue to closely follow future developments regarding this work stream.

Yours sincerely

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