Kuwait Finance House Bahrain's (KFHB) response to the BCBS's consultative document on "Revisions to the Standardised Approach for credit risk"

1. Introduction

We would like to thank the Basel Committee on Banking Supervision ("BCBS") for the opportunity to comment on its consultative document "Revisions to the Standardised Approach for credit risk" (the "Consultative Document").

We set out below our feedback on those aspects of the document that we consider the most important and hope that our comments below will be of assistance and offer an additional point of reference as your work towards finalizing the rules.

2. General feedback

Although we understand the desire to apply standardised, simplified and conservative tools to assess bank capital requirements, the scope of application of such standards should be carefully evaluated.

The identification of risk drivers should cater for different types of sectors, competitive landscape and regional adaptation of regulatory frameworks including for Banking Institutions Offering Islamic Services.

Simplified standards may give rise to biases that are even more significant than those they are supposed to address, thus distorting credit origination practices and pricing in the credit and financing/loan markets.

3. Proposed revisions to the standardized approach for credit risk to Exposures to banks

- We believe that the chosen risk driver/metric should be addressed as a part of the Pillar 3 requirements and be made publicly available in regular and more frequent time horizons to help in the assessment of credit worthiness and readjust the risk weighting appropriately with changes in the financial situation of the banks.

- We believe that CET1 ratio is a good metric but can be further enhanced with the non-risk based simple leverage ratio.

- We believe that other risk drivers can also help in the overall risk assessment of banks such as metrics relating to the funding structure and short term liquidity such as NSFR and LCR. In jurisdictions where Basel III are not yet implemented, other metrics can be used such as loan to deposit ratio and metrics that capture reliance on short term money market funds to fund the balance sheet.

- We also note that some exposures to banks which have acceptable CET1 ratios and slightly above average NPA ratio might receive the same risk weight as a small and slightly leveraged SME. As such, we believe that a calibration of the risk weight should be performed across the different categories.

4. Proposed revisions to the standardized approach for credit risk to Exposures to corporates

- As capital requirements for banks are an important determinant of the rate for loans and credit facilities granted to customers, the high risk weights for corporate's based on revenue and leverage as risk driver would end-up in a significant push of financing costs for corporate SMEs.

- The proposed two risk drivers might remove a number of quantitative and qualititative factors that are key to the credit risk assessment that are covered under a full external credit rating assessment, potentially reducing the risk sensitivity of the measure.

- We believe that additional risk drivers can be added to better reflect the riskiness of the obligors such as funding structure, diversification of obligors sources of income, and cashflow measures.

- The definition of an SME or regulatory retail, and ranges used should be calibrated based on different industries/geographical regions/countries.

5. Proposed revisions to the standardized approach for credit risk to Exposures to claims on real estate

- We believe that option two for exposures secured by commercial real estate better reflects the underlying economic driver for such exposures, ie assigning a RW of 75% to 120% based on LTV ratio.

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