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24th June 2016

Mr. William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Mr Coen,

Re: Consultative Document, Reducing Variation in Credit Risk-Weighted Assets - Constraints on the Use of Internal Model Approaches

Malayan Banking Berhad (Maybank) welcome the opportunity to provide feedback on the above-mentioned consultative document.

Being an IRB bank with more than 85% IRB coverage, we have earlier responded to the BCBS' second consultative document entitled "Revisions to the Standardised Approach for Credit Risk" issued in December 2015. Our main intention was to ensure minimal impact to the incentives that currently exists for institutions that chose to adopt the more sophisticated IRB approach instead of the Standardised approach.

With this new BCBS consultative document entitled "Reducing Variation in Credit Risk-Weighted Assets - Constraints on the Use of Internal Model Approaches", the Committee has maintained its stance to link the IRB capital requirements with that of the Standardised approach, via the imposition of the aggregate capital floor.

Maybank remain consistent in our view as before, that capital incentives still play a role in key decisions, despite other benefits of adopting internal ratings in the operations of a bank. An aggregate capital floor linked to the Standardised approach will eliminate a lot of the capital benefit currently in place. It is a regressive measure and runs contrary to the spirit of encouraging banks to migrate to a clearly more sophisticated approach under the credit risk capital standards. Should the impact from the floor become too severe, given the costs of maintaining a fully compliant IRB rating systems, questions will inevitably be raised on whether the banks should continue to remain under the IRB approach.

The Committee should also consider the timing interplay between the proposed measures and the upcoming implementation of FRS9 in 2018. Potentially significant additional provisions from FRS9 could create pressure on retained earnings and capital, in addition to the stricter capital requirements proposed in this consultative document.

Maybank is also of the view that reverting to the Standardised approach for several portfolios are drastic measures that would lead to a significant loss of risk sensitivity and potential unintended consequences of adverse selection. These measures run the risk of dismantling the significant progress already achieved in risk modelling for those portfolios, and may prevent future investment in the latest techniques. Before resorting to such measures, we urge the Committee to consider intermediate but viable alternatives, such as removal of LGD options, strengthening modeling practices, imposing model parameter floors and finally, Pillar 2 add-ons for model risks.

Maybank's detailed response on the consultative document is included in the Annex. As a member of Institute of International Finance (IIF), Maybank also contribute to IIF's initiatives and supports some of their alternative proposals - some of which are shared in our detailed response.

We would be pleased to discuss these comments further at your convenience should the need arise.

Sincerely,

Dr. John Lee Hin Hock
Group Chief Risk Officer
Malayan Banking Berhad

Annex: Detailed Response on Consultation Items

Our comments to the key proposals in the consultative paper are summarized below.

No	Section in doc.	Proposal	Comments
1	2.2	Reverting to the Standardised Approach for : • Bank and other financial institutions • Large corporates	Reverting to SA could result in: • Loss of risk sensitivity • Under-statement of risk on weak assets • Herding behavior and portfolio homogeneity amongst industry players, due to over-reliance on external ratings As alternatives to the SA proposal, we urge the Committee to consider: • Allowing PD modelling, while removing option for LGD modelling, since data scarcity is more pertinent for recovery estimates • Prescribing a more constrained PD modelling approach, similar to the supervisory slotting approach, to limit variability in assigned PDs • Instead of prescribing blanket SA treatment, allow IRB approach for portfolios that meet more explicit, data sufficiency requirements (e.g., minimum of 20-50 defaults)
2	4.3	Parameter estimation practices: Exposure at default and credit conversion factors	We believe that the CCF of [50%, 75%] being considered is too high for unconditionally cancellable commitments. We propose a CCF similar to what is being considered for retail - between 0% and 10%. Furthermore, we feel that facilities with conditions precedent should only be raised as commitments once the conditions are satisfied, not before.
3	1	Aggregate output floor, to replace Basel I floor	Care should be taken to ensure that the floor is not set too high. Calibration at an appropriate level is crucial to maintain adequate incentive for banks to manage the cost of maintaining IRB status. Suggest to retain Pillar I requirements without floor, but impose additional buffers under Pillar II to address model risk issues. Additionally, propose to remove the 0.6% RWA cap for surplus EP - EL to soften blow from imposed floor.

1.1 Reverting to Standardised Approach for banks, other financial institutions and large corporates

We believe that it is important to differentiate risk across different borrowers, and that reverting to SA would result in a loss of risk sensitivity due to the limited differentiation under the SA framework. A corollary effect of this is an under-statement of risk on weak assets and an over-statement of risk on strong assets, which is undesirable from a risk management perspective. Furthermore, an over-reliance on external ratings could lead to herding behavior and portfolio homogeneity amongst industry players.

While we acknowledge that current practices and techniques may result in models aiming at a level of precision not supported by data, we believe that proposing the other extreme approach, of reverting back to SA, is unnecessary. Instead, we support IIF's proposal that banks still be allowed to utilize internal models, but in a more constrained manner similar to the supervisory slotting approach. In this approach, banks would still produce internal ratings, but these ratings would be used to assign assets into prescribed risk buckets, rather than to produce a precise PD. This approach constrains the assigned risk parameters to the prescribed values of each bucket, thus reducing the dispersion in the levels of estimated risk, while still allowing banks to utilize internal models to rank the relative riskiness of each borrower.

Furthermore, we feel that the issue of data scarcity is more pertinent for recovery estimates. For PD models, risk ranking ability can still be proven via the shadow bond modelling approach. Therefore, we suggest that the option of LGD modelling be removed, in acknowledgement of data scarcity constraints, but that the option of PD modelling be kept available for banks. If the Committee is concerned about the low-default nature of these portfolios affecting the reliability of internal PD models, one option is to prescribe explicit data sufficiency requirements for banks wishing to adopt the IRB approach, e.g., need at least 20 - 50 defaults, instead of prescribing a blanket SA approach for all banks. Portfolios that do not meet the data sufficiency requirements could then either fall back onto the SA approach, or, when applicable, be collapsed into adjacent segments (e.g., large corporates and mid-corporates) to ensure a larger default pool for modelling.

1.2 Parameter estimation practices: Exposure at default and credit conversion factors

With regards to unconditionally cancellable commitments, we note that the Committee proposed that facilities with conditions precedent be included under the definition of 'commitment'.

We believe that facilities with conditions precedent that needs to be satisfied before drawdown should be raised as a commitment upon satisfaction of the conditions, not before. Examples of what we believe are justifiable conditions are:

- Approvals obtained from local authorities
- Confirmed sales target to be met
- Proof of completion based on architect or engineer's completion.

Furthermore, the Committee also proposed that the 0% CCF for unconditionally cancellable commitments be replaced with a number between 50% and 75%. We believe that the proposed CCF of [50%, 75%] is too high for commitments that could only materialize at the unilateral discretion of the bank. For products that truly allow the bank to cancel the facility at any time, and where justified by empirical evidence and demonstrable controls and legal rights, we feel that a 0% CCF should be acceptable. At a maximum, we feel that the prescribed CCF for non-retail UCC should not be higher than the [0%, 10%] range being considered for retail UCC.

1.3 Aggregate output floor

With regards to the aggregate output floor that the Committee is considering to replace the Basel I floor, we urge the Committee to exercise care that the floor is not calibrated too high. Calibration of the floor at the appropriate level is critical to maintain adequate incentive for banks to manage the cost of maintaining IRB status (e.g., maintaining dual systems, hiring specialized resources, performing annual validation, etc).

An alternative suggestion that we propose is to retain existing Pillar 1 requirements without a floor and instead impose additional buffers under Pillar II requirements to tighten risk sensitivity or model risk issues. Additionally, we propose that the 0.6% RWA cap for surplus Eligible Provisions net Expected Losses be removed, to soften the blow of increased capital requirements from the imposed aggregate floor.