

Comments of the KNF - Polish Financial Supervision Authority to the Second Consultative Document *Standards: Revisions to the Standardised Approach for credit risk*, issued for comment by 11 March 2016.

Polish Financial Supervision Authority is pleased to be given an opportunity to provide its comments to the Consultative Document *Standards: Revisions to the Standardised Approach for credit risk* issued by the Basel Committee on Banking Supervision.

Comments on the section:

Exposures to multilateral development banks (MDBs):

1. The proposed approach will reflect the underlying risk better than the current one.

Exposures to banks:

2. Under the Standardised Credit Risk Assessment Approach, assignment of risk weight to exposure dependent on the expected capacity to meet financial commitments as well as regulatory requirements by the counterparty is sensible. It is nonetheless crucial to assure the comparability of the grades assigned by different banks through setting the very precise criteria. Such criteria are also necessary to enable verification of the banks' approach (checking if the risk weight is not too low).
3. It is very important to be aware of the dangers stemming from the potentially inconsistent implementation of Basel Capital Standards. Differences in local approaches will have a negative impact on the comparability of outcomes across all banks. Not only are the potential regulatory differences a major problem, but also the verification of the calculations done by banks on international level may be problematic. Even though the risk weights do not stem directly from the capital requirements per se, but from the exceeding of the published minimum regular requirements set by local authority, the difference in the local approach resulting in the different reference values will be a problem.
4. The "excess of the published minimum regulatory requirements" criterion should be clearly defined. If even a slight excess is understood as a trigger then the difference between A and B grade boils down to the compliance with buffer requirements. If it is not the case, the required minimum level of excess should be established. Therefore, to make the rule transparent, the condition for assignment to grade A should be clearly stated and the level of excess should be defined.

Exposures to corporates: General corporate exposures

5. It is questionable if an 85% risk weight for unrated exposures to corporate SMEs (defined as corporate exposures where the reported sales for the consolidated group of which the firm is a part is less than €50 million) is adequate. Decision on the preferential rate for SME exposures should be based on data. Observations from Polish market suggest that SMEs are not less risky than corporates.
6. Other proposed solutions are in line with the current practice, are deemed adequate and raise no concerns.

Exposures to corporates: Specialised lending

7. Having in mind the higher level of risk connected with these exposures, in relation to other corporate exposures, it is justified to set for them separate, higher risk weights.

Retail exposures

8. Proposed criteria for the preferential risk weights are in line with the ones currently envisaged under Basel III. It is sensible to point out directly that for the rest of retail exposures (not meeting all the criteria) the risk weight of 100% should be applied.
9. Proposed 0,2% granularity criterion is adequate (with the option/discretion to use alternative method developed on the local level).

Real estate exposure class

10. We are satisfied with the risk weights based on the LtV for this kind of exposures.
11. Having in mind the specificity of the real estate market, where large differences between countries exist, adjusting risk weights to local conditions is justified.

Add-on risk weight to certain exposures with currency mismatch

12. In Poland there is currently a risk weight of 100% for real-estate exposures with currency mismatch. The proposal to raise the risk weight only with relation to the retail and real estate unhedged exposures is justified.
13. Having in mind the additional risk stemming from the currency mismatch we are satisfied with the proposed add-on of 50%. It is worth noting, that the minimum risk weight for real-estate exposures would be 75%, for loans with LtV between 80% and 90% it would be 95%, and would rise up to 125% or 150% for LtV over 100%. Such solution would be in line with the approach taken in Poland, proving its appropriateness. The proposal is important also because of the parallel work on EBA technical standards concerning conditions for raising the risk weights of real-estate exposures and ongoing discussion on the necessary level of discretion left for supervisors versus making this decision conditional in particular on the occurrence of losses. The Committee's proposal unambiguously points out that the higher risk weight should be dependent on the higher level of risk and not on the materialization of this risk.
For the sake of clarity – the document should mention the increase of the risk weight by 50pp. rather than the 50%, as the latter might suggest raising it by half.

Off-balance sheet items

14. We are perfectly satisfied with the proposal of raising the zero risk weight to 10-20% for retail commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. Zero risk weight raise moral hazard concerns, and while unconditional cancellation at any time without prior notice is not unambiguous, assigning higher weights is justified.