27.03.2015
3.0.0/11042
00000063309

POLISH BANK ASSOCIATION

Kruczkowskiego 8, PL 00-380 Warsaw, phone: +48 22 48 68 180, +48 22 48 68 190, fax +48 22 48 68 100, e-mail: info@zbp.pl, www.zbp.pl

Warsaw, 26 March 2015

Basel Committee

on Banking Supervision

Polish Bank Association response to the BCBS consultation on Revisions to the Standardised Approach for Credit Risk

Dear Sirs,

General comments

PBA welcomes the opportunity to comment the proposal of new standardised approach for credit risk. The approach proposed by the BSBC can be treated as the next step in construction of sound new principles of capital requirements for banks. These new principles should combine in better way all elements necessary for sound prudential regulations: sensitiveness, simplicity and comparability.

Before we explain our detailed comments to the consultation paper we would like to indicate that the proposed time of consultation is not the best one for the banking sector. The industry is nowadays deeply involved in the process of implementation of Basel III requirements, particularly the banks in Europe. This situation makes difficult for us to divide our attention into two important task: correct implementation of Basel III requirements and deep analyzes of new BCBS proposal. We would like to indicate two aspect of this problem. Firstly, it is difficult to access correctly new proposal when we do not have the knowledge about the full consequences of Basel III implementation in banks. The introduction of Basel III results in the change of capital and liquidity requirements and in the necessary changes in business activity of banks. We have to analyze these consequences first, before we will be ready to assess the potential results of new regulatory proposal. Secondly, we face the human nature's problem. Almost all staff responsible in banks for prudential regulation and risk management is now deeply involved in activity which is strongly connected with current implementation of Basel III in their financial institutions.

That is the reason why we recommend strongly to make the second round of consultation with the industry in regard to this project, particularly when the result of the quantitative impact assessment made by the BCBS will be known and the final proposal of calibration will be delivered by the Basel Committee. In our opinion the analytical assessment of economic consequences of new approach for the industry and for the economy is as important as correctness of theoretical model of prudential regulation.

In our opinion the proposed new prudential approach should make changes in these regulations which should be improved but, at the same time, it is important to maintain these elements of present solution which seem to be adequate and do not have to be changed. We accept the general idea to make new regulation as simply as possible. This approach is consistent with the principle of proportionality. We have in mind that the same regulations are used in practice not only by the biggest banks but by the smaller one as well. The complicated solution is very burdensome for implementation in small banks, it generates disproportionally higher costs for them in comparison to situation in bigger banks and very often it is not necessary in the types of services which are provided by small banks.

The practical applying of principle of proportionality is therefore very important issue for smaller banks, particularly in area of the proposed standardised approach's standards. Small and part of medium-sized local banks will not apply advanced methods, so this approach is very important for them. We recommend also to reconsider the possibility of choosing by the small banks the option to apply the current standardised regulatory approach. Otherwise, we are concerned that it will be very difficult task for them to construct and adopt their internal system which will be suitable to proposed new capital requirements.

Thinking about the applying the present capital requirements, we have in mind also the possibility of application of external ratings. The general proposal to eliminate the external ratings is very drastic and should be taken into consideration again. We know that the use of external ratings have brought many negative experience, negative consequences in the past, particularly before last financial crisis, and we know few disadvantages of their application in prudential requirements. However, we are not sure if full and single substitution of external ratings by the internal ratings will be the best solution in all areas of banking activity. Probably the supervisors have analyzed the experiences of banks up to now in real application of internal ratings. Nevertheless, we have to remember that the BSBC proposal goes in direction to apply the internal ratings in fact by all banks. We score that broadening the scope of banks using internal ratings in their capital calculation may substantially reduce the efficiency of application of this method. The smaller banks may not have the sufficient resources and tools to analyze or investigate deeply all factors of economic situation of their clients in such way to construct in proper way the matrix of internal ratings. These banks should still have the right to use the external rating in limited area for prudential regulation purpose.

Certainly we should not loose last experience and maintain in final version of new requirements these sophisticated elements which are used by banks efficiently and work in practice well. We are conscious that risk management is not easy matter and it can not be implemented by prudential requirements only. It is very important for us that the proposed solution, particularly risk parameters are calibrated in proper way, justified by empirical evidence of the BCBS.

The BCBS consultative document expresses the general statement that its objective is not to increase overall capital requirements. However, the values of the parameters and factors proposed in text clearly indicate a significant increase in capital requirements. We recommend to make the proper assessment of the proposal and to minimize its economic impact on banks and economy. We have to remember that bank have made big economic efforts recently in order to raise their capitals and next such effort should be strictly limited in next few years.

We want to pay your special attention to the adequate implementation timetable of new approach. The banks have to have the indispensable time to collect all necessary data and to build the correct calculation methods and to introduce significant changes in their IT systems in order to implement the new regulation in proper way. Banks have also to have necessary time to adapt the level of required capital to the new regulatory approach in such way in order not to destabilize the financing of economy.

We recommend the BCBS to publish the timetable of further steps of its activity in area of revision of standardised approach for credit risk, but also further steps concerning further works in area of the market and operational risk. This message should build trust and will allow banks to adopt effective solution in right time.

Detailed comments

EXPOSURES TO BANKS

In our opinion, external ratings remain a suitable approach for bank exposures. Nearly all banks active on the interbank market have an external rating and the assessment made by rating agencies is in our opinion more responsive in reflecting new bank development than the proposed risk drivers: capital adequacy or asset quality ratios. Completely removing references to external credit ratings would be going too far in our view. A credit rating issued by a recognised credit rating agency contains in its assessment far more information than the parameters proposed in the BSBC consultative document and may be more adequate for right assessment of bank position.

We are therefore in favour of continuing, under the standardised approach, to base applicable standard risk weight for exposures to banks (sometimes also to corporates) on external credit ratings. Only in situation where no external credit rating is available should the risk weight be based completely on the new proposed parameters.

The regulator should investigate deeply again the rationale for treatment of covered bonds in the same way as other bank exposures. We have to remember that issuance of covered bonds is regulated in special prudential regulation concerning this form of banking activity. There are strictly defined criteria of issuance which minimize the risk of default. These stricter regulation should be expressed in more favorable treatment of covered bonds as the risk driver for bank exposures. We would like to underline also that the covered bonds are now treated by the European Commission as very important tool of financial market development in near future. It would be difficult for banks to accept that different new regulations concerning the treatment of these bonds will go in opposite direction (more or less favorable for issuance) on the same time.

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 express above our reserve to the application of capital adequacy as risk driver. However, if the capital adequacy ratio is to be adopted as one of parameters for prudential calculation we prefer to use the total capital ratio as the basic risk driver. Until now the role of the leverage ratio as indicator of safe bank activity is limited, particularly in Europe. In our opinion it is treated more as additional indicator but not as the most important one. As we expressed many times earlier during our responses to regulators concerning the role of leverage ratio, this parametric is not so adequate indicator of capital position of bank as total capital ratio or CET 1. It does not take into account of the real level of risk generated by bank and therefore the unique use of leverage ratio as the parametric of bank capital strength is not correct for us.

The regulator's decision to use the capital ratio as risk driver in capital requirement calculation will probably generate many operational problems. They should be taken into account before the final decision cornering its implementation will be made. Firstly, banks will need the access to database of capital adequacy ratio of all banks active on the local market but also abroad. The principal question concerns the body/institution which will be obliged to deliver the database to banks. Should each bank deliver this message to its counterparty or the local supervisor will do it? If the first solution will be chosen the new question should be asked: in which way the banks will have the possibility to verify the correctness of information presented by their counterparties. Until now the common practice is that supervisors do not publish the individual economic indicators of every bank having in mind the risk of delivery of this information for stability of financial market and for every institution separately. Secondly, the question concerns the eventual inclusion of additional capital buffers into calculation of risk driver. Basel III recommend to supervisor to add some capital surcharge for some or all banks under its jurisdiction. Higher requirements will put mainly on bigger banks (particularly SIFI). This approach will generate the question if the application of higher requirements for bigger banks will automatically cause lower capital requirements for their counterparties? This solution would not be justifiable, because higher capital of these banks will be the result of administrative decision but not the effect of their own decision.

The same operational problem generates the treatment of additional capital under pillar II rules. The supervisor has to have the reason why the pillar II capital has to be established in bank. This reason is higher level of risk generated by individual bank. Should this additional requirement be really treated as positive indicator for risk assessment concerning the interbank exposure? We are not convinced that this additional requirements set up by the supervisor should be taken in favour of treatment of interbank exposure vs. other banks without pillar II capital.

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?*

The NPA ratio is just one more measure of risk in the dashboard of a Risk Committee but its use as a single risk driver poses many problems. The most important are namely:

- the net NPA focuses only on the probability of default, therefore it misses other important components of risk like the loss given default and the exposure at default. All these indicators have to be used in risk management,
- the level of net NPA depends strongly on the bank strategy and type of bank exposures. Banks engaged more deeply in consumer credits will have traditionally higher NPA level than the banks engaged in mortgage credits,
- the level of NPA can depend on the real possibility to sell the part of credit portfolio by banks. For example, banks engaged in consumer credit will probably have the bigger possibility to sell the portfolio of bad debts and diminish in this way their level of NPA than the banks more engaged in mortgage or corporate credits. This factor should be taken into account proposing finally the level of net NPA as risk driver,
- the level of NPA may be misleading for counterparties when bank is broadly engages in operation on capital market. Its level of NPA may be low, but it do not guarantee that the activity of bank generate low risk only,
- we have local experience indicating that other factors have the impact on the level of NPA in banks. The good example is the tax code, particularly the fiscal treatment of bank provisions. The conservative tax approach generates usually higher NPA level in banks being in such jurisdiction. Therefore, the results achieved by individual banks will be difficult to compare in international scale,
- accounting practices concerning definition of default differ in important way in different countries but also in the same country. Banks using the IRFS have different accounting standards than credit institutions applying local accounting standards. This factor has impact on the level of NPA and on estimation of value of credit collaterals. These differences will have a significant impact on the level playing field, if the new BSBC approach will be adopted,
- the low level of the net NPA is not the main indicator of good risk management in bank. Bank can have the special business model. It can make business in special niche where its activity can generate higher level of net NPA. But it does not mean the bank is more risky than other banks. The most important element of proper risk management is the right estimation of

expected losses which have to be covered by higher margin generated on all credit portfolio. In this situation the dynamic analyse is more important (the changes of the net NPA in time than the static approach – total level of net NPA) than the static assessment of level of net NPA,

- similarly as in area of the total capital ratio the bank will have the operational problem to receive the adequate information concerning the level of net NPA in each bank. The present discussion in the EU in area of the level of contribution paid by each bank to the bank guarantee fund (including the risk factor) indicates clearly how delicate is this matter and the banking society will probably not get the sensitive information about the economic condition of every bank. The full access to such type of information could be dangerous for weaker bank worsening its financial situation and probably speeding up the bank default. This solution will not give time the supervisor and resolution authorities to react adequately.

Naming all above-mentioned practical problems with implementation of net NPA as the basic risk driver we maintain our reserve about practical application of this indicator as the proper one for capital requirement purpose.

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

We accept the general result that the short-term interbank exposures generate lower risk for banks which deliver the money. This approach is consistent also with the maturity adjustment in the IRB approach.

However, we have in mind that implementation of this approach will have negative economic impact on the situation on the interbank market. We are afraid the maturity of exposure in the future will be shorter and there will be no chance to rebuild the liquidity of interbank market with longer maturity.

Looking at the maturity as the risk driver we would like to pay your attention that the residual maturity, not the contractual maturity, should be better indicator of exposure risk for bank.

The floor risk weight of 30% means a 50% increase in the capital charge for short-term interbank claims in comparison with actual regulation. it is difficult to treat is as slim adjustment and it will have impact on situation on interbank market.

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?*

The proposed regulation does not include special rules concerning the treatment of exposures between banks belonging to the same network. These rules are very important and necessary particularly for network of cooperative banks. Such structure of activity of cooperative banks is in Europe tread nearly as mandatory solution. The interbank exposures between banks belonging to the same network are hence necessary. These smaller banks, members of network, do not have also the ratings for their counterparties. We recommend to establish special rules concerning this type of banks and network.

The special form of bank network is the institutional protection scheme (IPS). This specific form creates additional duties and responsibility for all members of IPS, minimizing the risk of big turbulences and financial problems for whole bank network. In our opinion the prudential regulation shall take into account the existing rules of cooperation between banks in the network, particularly when the cooperation in network is mandatory for certain category of banks. The prudential regulation should also take into consideration the level of guarantee given to banks by other members of network. The lack of this special approach in this area may generate both misleading signals for some banks and will cause return to discussion about the preferred form of institutional cooperation between cooperative banks.

EXPOSURES TO CORPORATES

Before answering detailed questions, we would like to express our general opinion concerning proposed prudential capital treatment of exposures to corporates. Generally, our opinion in this area is very similar to proposal presented in area of bank exposures. In our opinion it is too early to eliminate completely external rating as the factor applied for prudential requirements calculation. Many banks may face principal problems to use the internal rating as basic parameter in process of calculation of their capital requirements.

In our opinion the scope of clients recognized as corporate is a very important issue for banks. In our opinion loans granted to investment funds or other financial institutions should not be treated in the same way as corporate exposures. The specific scope of activity of these institutions and other type of information required by banks from funds make the difference between them and corporates essential. Taking into consideration the requirements proposed by the BCBS for banks, a higher risk weight should be applied for investment funds with no regard to the true risk profile of these funds.

Looking again at the scope of institution treated as corporate in the BCBS proposal it is necessary to decide if the same rules should be used for small enterprises which are not obliged to publish its statement, which do not make full statement or the statement is not audited. The same rules applied for exposures to smaller enterprises and to the bigger ones will surely cause unexpected consequences. In our opinion it is necessary to apply different risk drivers for smaller and bigger enterprises.

Similarly as in area of bank exposure, the issue of divergent accounting standards is also critical for correct applying of risk drivers and implementation of sound prudential requirements for banks.

The assigned risk weights for corporate exposures appear to be overly conservative. We assess that the risk weight for best clients can be much higher without empirical evidence in proposal that it is proper approach.

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?*

Revenue and leverage are seen as blunt instruments of risk measurement of corporates. In our opinion the turnover can not be treated as an appropriate measure of risk. This measure is nominal value and not any indicator and this solution will make impossible to compare the situation in different corporates. It is difficult to convince that the corporate with higher revenue is always in better economic situation than one with lower revenue. The banks should not grant the credits to the big enterprises only.

We believe that an absolute measure as the revenue will create a big disadvantage for smaller firms and will not reflect their capacity to generate profits or their balance sheet robustness. It does not include also the cost side of income statement.

We recommend to replace the revenue risk driver by a relative measure like the return on assets or the return on equity in order to reflect better the profitability but not the nominal magnitude of the firm.

If regulator decides to implement revenue as a risk driver, the level of revenue should be differentiated by group of countries using purchasing power parity. It should be done to not to discriminate small entities in lower developed countries.

If the same rules are to be applied for all kinds of corporates, we have doubts concerning the applying the leverage. The financial institution as investment funds, insurance companies have in natural way higher level of leverage than the industrial enterprises with bigger share of real assets in their balance sheet. This argument takes us to the conclusion that the level of leverage should be adapted separately to different type of industry.

If the regulator decides to implement the leverage as risk driver, we are convinced that off-balance sheet leverage should be also included in the calculation of indicator. This approach is more fair, may assess the level of risk in better way but we have to be conscious that at the same time it makes the total calculation more complex issue.

Regardless of the risk drivers chosen by the BCBS, new approach would imply preparing of new process of proper quality data acquisition, extending the process of data input to IT systems for calculating capital requirements and rebuilding of calculation algorithms and reporting tools.

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?*

The proposal puts a heavy burden on the SME financing by banks. According to European Union SME factor 0,7619 implemented in CRD IV, there should be an incentive proposal for SME rather than putting SME outside banking system by increasing cost of capital (for instance by giving 300% risk weight) as it was explained above.

We regard the proposed approach as not supportive for external financing of SMEs. The proposed approach will make debt more expensive for type of enterprises which constitutes a key part of the economy in many countries.

During further works it should be taken into account that numerous SMEs are not obliged to publish their financial statements and therefore, this lack of information would penalise them because of application of the proposed drastic 300% risk weight. This rule will tighten credit conditions for these enterprises and have the impact on access to bank credit.

Calibration of risk weights shows that small companies are put at a disadvantage in comparison to larger ones. We can accept that the statistical evidences may prove that big companies go bankrupt less often than small ones and that the quality of bank exposures for larger enterprises is often better than exposures for SME. But there are different reasons of this diversification and these results are only one side of the problem. We have also to remember that majority of SMEs does not have the access to financing on capital market. The venture capital funds are not so popular in Europe as the source of external financing for the SMEs. The developing economy may grow mainly due to creativity of new entrepreneurs who set up their start up enterprises and thanks to the elasticity of the medium-sized firms. They create many workplaces in the whole economy. The proposal of new capital requirements presented by the BSBC will introduce in fact substantial tightening of access to bank credit for SMEs. These enterprises will have lower revenue and also will probably have higher leverage ratio. Both criteria will work against them. We should ask question concerning the perspective of future financing of SME activity. Such approach will generate economic, social and political tension in the future.

Accepting the higher probability of default in SME bank portfolio, we should look for instruments which will calibrate correctly the risk taken by banks but also will give chance to the SMEs to develop their business. We therefore suggest adopting separate risk weights for large companies and SMEs and calibrating these separately.

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

Our proposal to split the corporate exposures between large corporate ones and SME ones can add some risk sensitiveness but the benefit of such action is clear.

Using external ratings where available, for banks that do not have internal ratings, can also increase the risk sensitivity without the excessive complexity.

Generally, the approach proposed by the BCBS is quite simple, maybe sometimes too simple if we compare it with business environment of banks. Any new changes proposed to the BSBC proposal will increase complexity and probably will generate additional cost for the supervised institutions.

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

We accept the general idea that specialised lending has a different risk profile than universal banking. Its risk is less diversified but the specialization allows them to control the risk on higher professional level than in universal banks where there are many types of risk and it is more difficult to manage all its aspects. We have also to remember that specialised lending is usually better secured by valuable assets and cash flows. So, the risk weight should be calibrated according to real experience and records concerning this activity, also including the level of recovery rates.

We recommend to propose regulation for specialized lending which will take into account its risk profile and simultaneously do not close the activity of specialized financial institutions. We have to remember that these institutions play special and important role in the economy, having usually significant impact on the level of long-term financing in economy.

SUBORDINATED DEBT, EQUITY AND OTHER CAPITAL INSTRUMENTS

We support to differentiate between risk weights for equity and subordinated debt, including other capital instruments. The ranking in the creditor hierarchy should directly be reflected in risk weights as different LGD is reasonable to assume. As a consequence, we think that for subordinated debt applying an add-on on the risk weight of unsecured exposures will be a better option rather than a flat risk weight.

However, it seems that the introduction of a 300% or 400% risk weight for publicly traded equity and other equity issued by banks is inconsistent with the 250% risk weight such investment would have if it was a significant investment, that is exempted from CET1 deduction due to the 10% threshold exemption under Basel III. Thus for interbank exposures in equities and other Basel III compliant capital instruments the 250% risk weight should be applied.

RETAIL PORTFOLIO

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?*

The general idea to remain the 75% risk weight approach to retail exposures is reasonable for us.

We are not in favour to any mandatory application of the granularity criterion. Lending precisely to SMEs would be hit by application of such limit. As a result, lending to SMEs would be made much more expensive or the scale of exposures will be reduced significantly. We are therefore against stipulating that retail portfolio diversification should be demonstrated through mandatory compliance with the granularity criterion and we are in favour of allowing other methods as well. We have to remember that there is the maximum volume criteria for applying the special rules for SMEs and additional factor as granularity may not be necessary. In practice this prudential condition causes many problems in application and different opinion expressed by banks and their supervisor.

The proposed approach in area of retail business is very general. This solution gives the benefit of simplicity. However, starting the discussion concerning the new rules we propose to investigate more deeply other approaches. For example, the consideration of different bank products could be one direction of further penetration. The special relation between bank and client, period of cooperation up to now could also have impact on the level of risk weight. The European regulation concerning the liquidity management could be good background for further investigation in this area (for example existence of the operational relationship between bank and client).

CLAIMS SECURED BY REAL ESTATE

It is quite obvious that national legal and economic circumstances are very important factors both for the choice of correct risk drivers and for their calibration on appropriate level. One example may be the national bankruptcy law. The probability of bank losses is obviously very different if the bankruptcy law allows people to walk away from debt without severe additional financial repercussions compared to situation if there are no personal bankruptcy where debt is written off, meaning that the debt remains with a defaulting borrower for the rest of the borrower's life.

From a practical point of view, we think that the level of current LTV, can not always be treated as the best risk driver for exposures secured by real estate. The level of LTV depends strongly on current situation on local mortgage market and it can change substantially during the life of exposure. In each country this problem should be analyzed separately.

The good example illustrating the need of different approach in level of LTV may be the standard of furnishings in new apartments/houses delivered by developers on local market. If this standard is relatively poor, in such situation the simple comparison of the value of credit and the amount expressed in the agreement signed by the creditor and developer is not sufficient. The real value of real estate will be probably higher after finishing the construction process because the creditor will make further necessary investment in order to adopt the apartment to the average living standard in the region. If the scope of furnishings delivered by the developers is broader, the creditor does not have to invest a lot more in new flat and the price included in agreement signed by developer and creditor represent nearly full cost of investment. This value included in agreement between developer and client will be different in both cases but it will be used in the same way for LTV calculation. In our opinion such approach is too simply and it is not correct. We should compare the value of credit with the average market price of similar apartment/house in the same region. This comparison is more valuable.

Our experience indicate that the DSC may be more adequate risk driver than LTV. We observe this problem nowadays in Poland in area of mortgage credits denominated in the foreign currency. Last big change in the exchange rate between local currency and currency of credit has generated big change in the level of current LTV. We observe that in the same time the change of present DSC is much more limited thanks to the changes in interest rate and level of spread used by banks. The DSC portrays the borrower's capacity to repay the debt at all times. The DSC concerns the present ability and the LTV works in longer time. The value of real estate can change in important way during usually long time of credit repayment. It can not be treated as the most important factor for making decision by creditor to repay or to not repay current installment. Particularly, if the real estate is used for own residential purpose the level of DSC is crucial factor, not the LTV.

Using the DSC as indicator of creditor's capacity to repay the debt, we have also to remember that riskiness of credit is not linear function of DSC. If the indicator is lower the capacity of repayment is disproportionally lower and the level of this difference depends on income bracket of each creditor. This remarks come to conclusion that more detailed analyses have to be adopted in this area.

Surely we should not ignore the LTV level as risk driver but our experience brings us to the conclusion that the DSC is more important driver. Of course, we are conscious of problems which can arise when we will have to analyze the present level of DSC of all bank clients, because the range of practical complications can make it very difficult to manage this process.

In our opinion the mortgage lenders and their clients may be strongly affected by the proposed new risk weight framework. The risk weight calibration will in particular have impact on mortgage loans typically ranged with LTVs of between 60% and 80%. In the current standard approach these exposures receive a 35% risk weight whereas it is level of 40% or 50% in the proposal. Looking at the volume of such exposures the consequences for banks will be high and will have impact on the access to the mortgage credit. In countries where there is deficit of apartments this change in prudential requirements can cause social and political problems.

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?*

As we expressed in our comment mentioned above, we agree that generally both drivers have predictive power of loan default. We give bigger weight to the DSC indicator, particularly when the real estate is credited for own purpose of creditors. The parameters for two categories of creditors (using real estate for own purpose or for renting) can be construct in different way, because other factors are most important for each of these groups of bank clients.

The LTV is quite simply indicator to manage the level of necessary capital requirement in banks. It is very often used in supervisory practice and banks have to collect the information necessary to analyze the current LTV level in their exposures. However, in practice the proper applying of this risk driver depends strongly on the bank access to good database, particularly external database. This requirement is outside the banking sector but it have strong impact on bank prudential requirements. There is the reason why updating the LTV is plausible solution in our opinion. Updating the numerator is simple and clear because the outstanding amount of the loan is available and it is a precise figure. Updating the denominator is more difficult and it is more complex, it is considerably expensive for banks.

The LTV has also one important shortcoming. It can generate the cliff effects, if the risk weigh depends fully on the present level of LTV. It can cut drastically the bank engagement in credit with little higher LTV.

Unfortunately, the DSC triggers have the same or maybe bigger shortcomings concerning the process of information updating. Today there is no common definition of the DSC in banking sector and formulating one that works across countries seems really unimaginable. There can be also an issue of legal right to have the assess the current information. If the creditor does not deliver the updated information, the bank will face negative prudential consequences but not client. On the other side, this indicator should not generate such strong cliff effect if is good calibrated.

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.)*

As stated in consultative document, in the numerator of LTV shall be taken into account only value of property and no other collaterals. In Poland it is common practice that banks take additional collateral which is linked to mortgage. That additional collateral is an insurance of low financial input of creditor and this insurance is the insurance of this part of credit value which is between total value of credit and 80% value of property when is lower than the facility. It is commonly proved that the effectiveness of recovery on the insurance is substantial. We recommend therefore to include that kind of linked collaterals into LTV numerator calculation when bank provides the effectiveness of recovery.

The LTV should be updated on the side of the numerator by taking the outstanding amount of the loan at each point in time. It is easy because it is data readily available in bank IT systems. It is fair because the risk profile of the mortgage loan changes so long as the remaining debt decreases. Regarding the denominator, an increased or decreased market value of the dwelling should reflect the risk weight for the exposure, otherwise LTV as a risk driver will provide less relevant information about the risk of possible loan losses. The problem is that mandatory property revaluations can be expensive and complex.

Regularly updating the DSC in particular would be difficult to achieve both in terms of time involved and willingness of borrowers.

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 DSC proposed by the BCBS is based on the borrower's net income. This solution may generate several problems. The net income after taxes and social benefits can be difficult to control for the lender. However, this system eliminates the incomes of creditors coming from grey market. In many cases this source of income is not the choice of creditor but he is forced by the employer to this form of employment. The money coming from grey market have also impact on the creditor's capacity to repay its debt. Nevertheless, from theoretical point of view this indicator is best suited to monitor the capacity of creditor to repay its debt and generally we accept this approach.

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?*

We would like to propose the BCBS to investigate complementary factors. Firstly, as it has been mentioned above, the purpose of credit can by important factor. Owner-occupied properties have a risk profile other types of mortgage loans than like buy-to-let. Secondly, additional guarantees on bank exposure may change substantially the risk profile of mortgage loans and should be included in matrix of risk drivers without big complication.

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?*

The treatment of Commercial Real Estate (CRE) as similar to unsecured exposures, as proposed in option A, does not seem to reflect the effective risk of these exposures, departing from an opposite view, which has been present in all European risk assessment exercises in recent years, that considers CRE as secured exposures. The look at these exposures as at the default risk consideration is not enough for this segment of bank activity. We think that some reduction in risk weight compared to unsecured exposures should be granted to recognize the value of collateral. The treatment of commercial real estate as unsecured exposure with the maximum risk weight of 300% can have strong negative consequences causing the reduction in the scale of this type of bank exposures and the growth of interest rate if the financing is offered.

Option B has also significant weakness. This option is based on expected recovery with the use of LTV indicator. We could repeat in this place the same argument which described the weaknesses of this driver in part concerning mortgage exposures.

If the regulator does not find better risk drivers for these exposures, we recommend to combine both proposed option as more complex approach than each on them.

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

No comments.

RISK WEIGHT ADD-ON FOR EXPOSURES WITH CURRENCY MISMATCH

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?*

We are conscious of generally higher risk generated by the FX exposures for individual persons which earn money in currency different from currency of credit. Until now this risk has not yet materialized in Poland. However, banks should be prepared to cover potentially higher risk of such portfolio by application of higher risk weight. This instrument diminishes successfully the scale of FX lending. It can be used as preventive instrument. We have to have in mind that the level of NPL in the FX mortgage credit exposures depends strongly on the rules concerning the process of granting these credits. In Poland there are some limits established by the local supervisor which diminish the probability of losses generated by banks in this portfolio. For example, the creditor in FX credit has to earn higher income and to be conscious of additional risk taken by him. Summing up, the proposed solution in this area should be therefore more sensitive and it should depend on the local rules concerning process of granting FX credits.

OFF-BALANCE SHEET EXPOSURES

The introduction of a 10% floor on low risk off balance items would have an effect on credit lines to financial counterparties. This will have impact especially on institutions in small currency areas which often have a limited number of money market counterparties.

The 10% CCF is unjustified because the counterparties are closely and continually monitored, therefore an immediate reduction of the credit line can be enforced. It is reasonable to establish any risk weight but it should be lower than the proposed one.

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

In our opinion the CCF goes too high in some areas. That concerns particularly commitments to corporates that a bank may unconditionally cancel at any time without prior notice. The 75% CCF for commitments that are not unconditionally cancellable at any time without prior notice is likewise too high in our view.

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.*

With reference to existing consumer protection rules, we can understand the 10% CCF for retail commitments that are unconditionally cancellable at any time without prior notice. There are no such rules concerning the corporate segment of banking activity. This segment of clients is monitored closely, so the reduction or cancelling of commitment is not rare practice. We therefore recommend to apply 0% risk weight in this segment for commitments that are unconditionally cancelable at any time without prior notice as appropriate.

PAST-DUE LOANS

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

The upcoming changes to accounting standards (IFRS 9) will result in a comprehensive framework for the expected loss of past-due assets. This development should be included in the final framework of risk weight as well, knowing that in prudential regulation the unexpected losses are important.

EXPOSURES TO MULTILATERAL DEVELOPMENT BANKS

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

We hope the proposed treatment for MDBs is reasonable.

OTHER ASSETS

Q20. *What exposures would be classified under "Other assets"? Is a 100% risk weight appropriate? (Please provide evidence where possible).*

No comments.

CREDIT RISK MITIGATION FRAMEWORK

We are opposed to any general ban on using internal estimates and models. Instead, banks which already have approved methods in place to mitigate credit risk should also be allowed to use these for CRSA purposes, as they are much more risk-sensitive than, for example, supervisory haircuts.

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

We estimate banks may experience a serious increase in capital requirements from this proposal. We think it is unwarranted.

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?*

No comments.

Q24. *What are respondents' views on the proposed corporate guarantor eligibility criteria?*

No comments.

Yours sincerely,

Krzysztof Pietraszkiewicz

President