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Mr. Stefan Ingves
Chairman
Basel Committee on Banking Supervision
Bank of International Settlements
Basel, Switzerland

June 23, 2015

RE: Revisions to the Standardised Approach for Credit Risk – Consultative Document

Dear Mr. Ingves,

The Real Property Association of Canada ("REALpac"), is Canada's senior national industry association for owners and managers of investment real estate. Our members include publicly traded real estate companies, real estate investment trusts (REITs), private companies, pension funds, banks and life insurance companies with investment real estate assets of over $300 Billion in Canada. REALpac would like to thank the Basel Committee on Banking Supervision (the 'Committee'), for consulting with stakeholders on *Revisions to the Standardized Approach for Credit Risk,* December 2014 (the 'Consultative Document').

We understand that, based on the Consultative Document, the Committee is looking to improve the standardised approach for credit risk in a number of ways, including:

- Reducing reliance on external credit ratings;
- Increasing risk sensitivity;
- Reducing national discretions;
- Strengthening the link between the standardised approach and the internal ratings-based (IRB) approach; and
- Enhancing comparability of capital requirements across banks

REALpac appreciates the need to protect local and global economies from significant economic crises, however, REALpac believes that certain proposed revisions to the standardized approach are problematic and may negatively impact bank lending to the commercial real estate industry. Specifically, the Consultative Document's focus on the counterparty in risk weighting may lead to unpredictability in commercial real estate ("CRE") credit decisions on the part of banks.

REALpac's most salient concerns with the proposed policy changes are:

a) **The Consultative Document proposals could lead to an unfair risk weighting for CRE loans structured for Special Purpose Entities ("SPE").** SPEs are used by commercial real estate firms to limit certain risks and encourage financing of real estate projects. The Consultative Document proposes that CRE loans that are structured as SPEs would be designated as "specialized lending" and fall within the "income producing real estate" category and therefore, be risk weighted at a higher rate. Income producing real estate would be risk-weighted at the higher of (i) 120%; or (ii) the risk weight of the applicable counterparty. If the weighting would be a minimum of 120%, that is a 20% increase from the current 100% risk weight attributable to real estate. We believe that this proposal runs counter to predetermined weighting and would penalize borrowers of real estate loans that follow the SPE structure.

b) **Methodology could lead to limitations on bank lending to real estate projects.** Basel III requires that real estate exposures be weighted at 100%, unless they are categorized as "high volatility real estate exposures" ("HVCRE"), which receive a weighting of 150%. Basel III also allows for a reduction of the risk weight to 50% under certain circumstances. The Consultative Document considers real estate as "high-risk" and proposes two options to improve risk-sensitivity; these are:

i. No recognition of the real estate collateral and treating the exposure as unsecured (ex. by assigning the counterparty (retail or corporate) risk weight ranging between 60% and 300% to the exposure); and
ii. Assigning a risk weight to the exposure from a table of risk weights ranging between 75% and 120% based on the LTV ratio.

REALpac believes that both options have far-reaching consequences for commercial real estate. The first option addresses the Committee's belief that the counterparty should be considered in risk weighting assessments but REALpac believes that too strong a focus on the counterparty may lead to bank lending decisions which are biased toward low-risk counterparties, regardless of the quality of the real estate deal proposal being considered. We recommend maintaining the current 100% weight category to prevent such a risk. The second option is more in keeping with the current bank credit decision process.

The regulatory changes as proposed in the Consultative Document should be carefully evaluated against the existing Basel III regulations and CRE underwriting procedures. REALpac believes that the Committee can assure a well-structured balance between its goals to ensure the availability of credit for CRE entities and the development of sensible underwriting policies. In our opinion, this would be best accomplished by maintaining the requirements contained within Basel III, and not deviating from the established risk weighting of 100%, with respect to CRE loans to SPEs. We would ask the Committee to consider the above-noted concerns carefully before enacting further regulations.

We invite any opportunity to discuss these matters moving forward.

With thanks,

Michael Brooks
Chief Executive Officer