Comments of Saudi Banks on the BCBS Consultative Document entitled: "Developments in Credit Risk Management Across Sectors: Current Practices and Recommendations" of February 2015

Banks' Comments:

Recommendation 1: Supervisors should be cautious against over-reliance on internal models for credit risk management and regulatory capital. Where appropriate, simple measures could be evaluated in conjunction with sophisticated modeling to provide a more complete picture.

	Comments
Bank 1	Since 2006, banks in developing countries have increased the level and sophistication of their credit risk models with an increasing tendency to use domestic data either directly from their own portfolios or through the use of national data pooling resources. Whilst Bank believes this has improved the predictive power of such models, Bank agrees that there are risks associated with over-reliance on models. The, sometimes, limited availability of historic data and short time horizons can restrict the ability of models to predict future outcomes with a sufficient degree of confidence, and thus such models are considered only useful to supplement other credit assessment techniques. In addition, the scarce availability of skilled technical resources to develop, manage, monitor and independently validate such models can challenge a bank's ability to sustain effective model governance frameworks and respond in a timely manner should issues arise within a model.
Bank 2	The strength of a simple methodology/ few rules to help evaluate a complex/ unpredictable problem has been well recognized in the field of complexity science. Similarly, this recommendation is well perceived and simple measures should be used as an essential supplement to assess risk from a logical and rational perspective.
Bank 3	Evaluation and management of credit in response to the recommendation that supervisors should be cautious against over-reliance on internal models for credit risk management and regulatory capital. Bank can confirm that Bank's risk management processes include a number of complementary qualitative and quantitative tools to assess the risks associated with potential corporate obligations. These include inter alia site visits, meetings with management, independent assessment by experienced risk officers and evaluation against a set of target market and risk acceptance criteria. The ratings provided by the Bank's internal rating models are therefore only one of a number of inputs considered to support the final decision on whether the Bank ultimately extend credit to the obligor.
Bank 4	Bank agrees with the recommendation related to models for calculating credit exposures. At present, regarding the proper measurement and assessment of counterparty risk associated with market transactions, the Bank has two different models for Credit Risk Management (CRM) and Replacement Costs

	(RC). For RC, Bank used standard Basel supervisory factors to calculate Add-Ons which are in turn plugged into capital calculation. For CRM, Bank uses MTM + Add-On based on add-on factors. These factors are developed from methodologies which are widely used across most sophisticated market participants. As such, Bank does not have concerns due to risk of loss caused by inapplicable parameters of the model or incorrect model specification and technical errors that could increase uncertainty and lead to model volatility. Additionally, Bank also employ simple techniques to estimate potential risks of a given transaction. Bank is constantly in a process of making enhancements in it's internal limit control framework by conducting regular diligence around monitoring limits, aggregating risk adequately, managing the breaches effectively and stress testing the portfolio.

Recommendation 2: With the current low interest rate environment possibly generating a "search for yield" through a variety of mechanisms, supervisors should be cognisant of the growth of such risk-taking behaviors and the resulting need for firms to have appropriate risk management processes.

	Comments
Bank 1	Bank does not support the assumption that all banks have undertaken a search for yield. From Bank's perspective, the bank has been focused on growing core banking activities and supporting the domestic economy through the provision of traditional banking services, with a sustainable, relationship driven business model.
Bank 2	The "search for yield" is a natural market-driven phenomenon and needs due attention from supervisors and also from the risk management function of a firm. The risk management infrastructure of a firm should be robust and sophisticated enough to cater to changing risk landscapes encompassing various market-based motives.
Bank 3	No Comments.
Bank 4	Bank agrees with this recommendation. Bank is not engaged in high yield lending with customers. Bank employs vigorous analysis to ensure customer suitability and appropriateness for all investments activities related to treasury and corporate bonds, lending & managing loans and Derivatives. As such, Bank's clientele consists - to a very large extent - of "investment grade" rated corporates. Thus, all efforts related to search for yield are prudently analyzed and monitored in agreement with all key stakeholders involved. For derivatives, Bank also employs potential future exposure based risk factors with 95% confidence approach - a stress test approach - and all limits authorized are the function of these factors.

Recommendation 3: Supervisors should be aware of the growing need for high-quality liquid collateral to meet margin requirements for OTC derivatives sectors, and if any issues arise in this regard they should respond appropriately. The Parent Committees (BCBS, IAIS and IOSCO) should consider taking appropriate steps to monitor and evaluate the availability of such collateral in their future work while also considering the objective of reducing systemic risk and promoting central clearing through collateralisation of counterparty credit risk exposures that stems from non-centrally cleared OTC derivatives.

	Comments
Bank 1	No Comments.
Bank 2	The need for high-quality liquid assets is further increased by the new Basel III related Liquidity Coverage Ratio. The recommendation for respective committees to monitor and evaluate the availability of such collateral in future work is endorsed. The issue is more pertinent for Sharia compliant banks due to the relative dearth of sharia compliant instruments in the market.
Bank 3	This recommendation is affirmed by Bank's policy of only accepting cash as eligible collateral for these types of transactions. There are also Credit Support Agreements in place with Bank's material counterparties with procedures in place for daily monitoring of the margin call requirements.
Bank 4	Bank agrees with this recommendation. At present, all of Bank's exposures are conservatively calculated on a Gross basis. However, Bank also has ISDA/CSA contacts with financial institutions to ensure continuous dealing in derivative products. Besides, Bank has been running key projects related to Dodd Frank, EMIR and CSA implementation. The emphasis has been to exchange bi-lateral margin calls on transactions based strictly on high and very liquid quality of collateral such as 'cash'. For current CSA customers, the scope of the products currently include vanilla IRSs with ability to mark to market positions in-house and exchanging collateral in $-Cash. For corporate customers, CSA is not generally applicable in the KSA environment.

Recommendation 4: Supervisors should consider whether firms are accurately capturing central counterparty exposures as part of their credit risk management.

	Comments
Bank 1	There is a growing trend towards the use of central clearing counterparties and collateralisation for foreign currency derivatives, however the level of collateral requirements are at present not material. One issue that may arise in the future is the need for local banks to post highly-liquid foreign currency collateral with counterparties, increasing the pressure on foreign currency

	funding requirements.
Bank 2	Given the trend in moving to CCPs for various asset classes/categories, it behooves firms to review and strengthen their current processes and controls related to CCPs. Supervisors should continue to play the role of recommending industry guidelines on this.
Bank 3	While there is currently no central clearing available within the region, the adoption of Basel III requirements in 2013 by banks operating in the kingdom has ensured that additional capital is required to be set aside on OTC transactions through the CVA capital charge. These measures should partially address some of the concerns raised of not clearing these transactions through a central counterparty.
Bank 4	Bank agrees with recommendation but believes it does not apply at present. Bank has been involved with the implementation of the EMIR project which is currently on hold due to changes in regulation framework and timelines. However, the key credit exposure methodologies have already been defined along with requirements such as diversification across at least two CCPs to avoid concentration issues. Bank also drafted a 2% minimum risk on CCP instead of 0% in order to prepare for the failure of the CCP due to uncovered losses resulting from financial shocks. These may be related to liquidity dislocations and credit losses or a major channel through which these shocks are transmitted across domestic and international financial markets thus causing greater than 0% credit risk to the Bank. Finally, margin requirements for central clearing of OTC Derivatives will require high quality liquid collateral. High quality liquid collateral is defined as cash and government securities. In developing countries, there is a paucity of government securities and Centralised Clearing of OTC derivatives will only exacerbate this situation.