Comments of Saudi Banks on BCBS Consultative Document entitled: Revisions to the Standardized Approach for Credit Risk

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BCBS Consultative Document: Revisions to the Standardized Approach for Credit Risk				
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?	While we agree with the reasoning for selecting CET1 ratio as a risk driver. However, we observe a number of issues: • While the definition of capital and the calculation of minimal capital requirements is largely compliant across jurisdictions (constituting the numerator of CET1 ratio), we are concerned about distortions in the CET1 ratio caused by the existence of excessive variation in RWAs for the same exposures (constituting the denominator of CET1 ratio). The is confirmed by the Regulatory Consistency Assessment Program (RCAP) findings which observed issues with RWA inconsistency and dispersion as well as extremely low levels of internally modeled RWAs. In our opinion, such distortions would reduce the comparability of the CET1 ratio. • As stated in the proposal,	• Capital Adequacy is a good predictive risk driver of Bank solvency, and CET1 ratio is superior for analysis on both ongoing and solvency basis • However, for the purpose of uniformity across all jurisdiction Leverage ratio is most appropriate since its denominator (on balance sheet equivalent) is prior to application of RWs where any National discretion may lead to inconsistency in RWA estimation. • Yes, Basel III calculations are necessary; but when not available use of Leverage ratio is also practical to estimate. • Given the proposed definition of "banks" that includes regulated Securities firms, we believe that two different Risk Weight matrices will be required since the business, risk profiles, and prudential regulations of banks and securities firms are distinguishably different from each other. • Furthermore, regardless of new proposal for "banks" asset class, we are of the opinion that external ratings should be continued as measure of RWAs (external ratings also address country/transfer risk element) while their risk weights could be recalibrated. Use of External ratings, where available, is still a better option as it captures lot	• In our view capital adequacy ratio is an acceptable measure to assess a bank's insolvency.	• We would prefer the CET1 ratio recalculated as per Basel III as a risk driver as it is a comprehensive, comparable and well established measure. The leverage Ratio is also a suitable measure but it was only introduced recently. Finally, when CET1 is available, we believe the Tier 1 ratio does not add significantly more information to the risk driver.

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	banks would have to use data disclosed in their obligors' most recent Pillar 3 reports. However, there are banks (i.e. non-international active banks) that are not subject to Pillar 3 disclosure. Moreover, CET1 ratio is not always published by securities firms and other financial institutions. Hence, we believe that the outright application of the highest risk weight of 300% RW to such institutions is punitive. Country risk could be used as a moderator to the risk weight applied on such institutions.	more credit related information (and available historical default experience by rating grades reasonably justify the assigned credit ratings); this suggestion also meet BCBS objectives of simplicity, easy to implement, consistency and uniformity. • In addition, external ratings are often reviewed/updated on the basis of obligor, geographic and market specific events, and therefore provide forward looking credit quality view/assessment – not possible in case of the proposed backward looking financial parameters/ratios.		
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 Committee proposes a more conservative measure of 30 days past-due as regards to non-performing investment debt securities and other interest-bearing balance for the definition of net NPA ratio. In our view, having a different definition of default than the current standard of	• Our last three bullet point comments to question one (1) above are also valid here. • In general NPA ratio is an effective measure for distinguishing credit risk of bank exposures • of credit quality of banking book exposures; however there is a need to address credit quality related component of trading book. • The use of this ratio may promote the practice of early write-offs i.e.	• In our view NPA ratio is effective in measuring a bank's credit risk. • An alternate measure could be comparing Net Non-performing assets to Common Equity.	• In our view, the NPA ratio can be an objective measure for credit risk as it should be comparable across all banks in view of common accounting standards used in the definition of NPAs. We believe that the alternatives such as credit risk exposures based on internal ratings or based on

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	90 days past-due would introduce misalignment between the standardized approach and the internal ratings-based (IRB) approach. This is contrary to the stated objective of increasing comparability of capital requirements under the standardized approach and the IRB approach by aligning definitions and taxonomy, where possible. • Net NPA ratio is not always published by securities firms and other financial institutions. Hence, we believe that the outright application of the highest risk weight of 300% RW to such institutions is punitive. Country risk could be used as a moderator to the risk weight applied on such institutions.	behavioral biasness. • The fundamental issue with NPA is that it is an indicator of **"EXPECTED LOSS"** and it falls short of predicting the likely "**UNEXPECTED LOSS"** - which is the issue on hand – it may be necessary to address this concern during calibration exercise via QIS.		distribution of the probabilities of default would not be comparable across all banks.
Q3. Do respondents have views on the proposed treatment for short-term interbank claims?	• Short-term interbank claims are normally rolled over. Excluding such claims from the preferential treatment of short-term interbank claims	• We agree with the proposed treatment; however, preferential treatment of short-term interbank should be equally provided to all banks irrespective of their risk	• We agree with it.	• We agree with the proposals contained in the document. For short term interbank claims with an original maturity of three

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	would have implications not only on capital requirements, but also on liquidity provisions among banks.	weights which already factor in the credit quality . • Otherwise, the proposed preferential treatment will not fully meet the defined purpose i.e. “not to effect the liquidity in the interbank market” • Proposed maximum 300% RW for banks not having Pillar 3 disclosures is very high.		months or less which are expected to be rolled over, they do not qualify for preferential treatment as per the guidelines. In such cases, a methodology of determining expected roll over on the basis of either contractual maturity or historical behavior needs to be specified.
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?	• Given the issues outlined above and the fact that bank ratings did not really suffer from the same weaknesses as ratings on structured notes and sovereigns, we suggest that the external ratings-based approach be retained for bank exposures. Risk weights for unrated banks should follow the current Basel II Option 2 approach for bank exposures, i.e. one-notch higher than the risk weight of the sovereign. Moreover, the same general rule under Basel II on the use of foreign currency and domestic currency rating should still apply, i.e. use international/foreign currency rating for exposures in foreign	• As suggested above, the use of external ratings should continue as the measure of RWAs since external ratings also address country/transfer risk element; the risk weights could be recalibrated. P.S. there is a notable trend where Central Banks encourage banks to seek ratings from external Agencies. • The proposed credit quality ratios could be applied to unrated banks and risk weights of these externally unrated banks can be recalibrated incorporating country risk element as proposed. • The above suggestions is also supported by our comments under Question 1 above on use of Leverage ratio, and can address those banks that have not implemented Basel III .	• Banks not subject to Basel III should be treated separately with a standard RW assigned to them.	• We believe that country risk is an important risk driver apart from the CET1 Ratio and asset quality. However, for country risk, we believe that a bank could rely on ratings by Moody’s, Fitch and S&P. We therefore believe that the BCBS should devise a look up table based on the available ratings to serve as the risk drivers along with the CET1 Ratio and asset quality.

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	currency and domestic/local currency rating, if separate, for exposures in the domestic currency.			
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?	We posit the following issues: • The definition of corporate exposures in effect creates a fallback category in which all exposures not belonging to other categories are included; e.g. securities firms and other financial institutions not subject to prudential standards, MDBs, etc. As such, this makes the corporate category inconsistent. Moreover, the proposed risk drivers may not be meaningful or even not available for certain entities (e.g. securities firms, non-bank financial institutions, insurance, etc.). Perhaps the approach can be made more granular by defining subgroups of corporate exposures and identifying a set of risk drivers for each subgroup.	• In general, the risk drivers and their composition seem acceptable in the context of need for simplicity and uniformity; however following concerns/comments are offered for further refinement: • Size of commercial entities/corporates measured through revenues could differ in different jurisdictions due various factors affecting "economies of scale" Market size, economic policy, local regulations. Therefore it is imperative that certain margin of difference is allowed via "National Discretion" • Proposed design of risk weight calibration (obligor riskiness) is likely to create "Selection Biasness" for the following reasons – that can affect credit availability: • Bias toward large revenue sized corporates due to use of absolute revenue size as risk indicator; could the use of a (performance) produce better address this biasness with an overlay of size as a factor? • The proposed risk weight matrix already reflects potential for "size"	• The proposed risk drivers are acceptable, however, the revenue bands should be increased from 4 to 5 by reducing the range of the third band from EUR 50mm to EUR 250mm (at 80% RW) and introducing an additional band ranging from EUR 250mm to EUR 1bn (at 70% RW).	• Leverage is generally defined as "Total Assets/Total Equity" as per the accounting standards. However, leverage could also include off balance sheet items as well. The BCBS could therefore propose Credit Conversion Factors for off-balance sheet assets. • We also believe that there could also be other credit risk drivers covering ratios relating to liquidity, profitability, operations, as well as industries/sectors. In particular, it is known that imminent causes of default generally relate to the lack of liquidity and we note that the BCBS has not proposed any liquidity measure as a credit risk driver.

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	• The assigned risk weights for corporate exposures appear to be quite punitive; this could be an intended consequence by the Committee to account for designating the corporate exposure category as a fallback category. Such intention in the proposal would potentially lead to a maximum risk weight for these "uncategorized" exposure. We observe, for example, that the risk weight for highly-rated corporates (AA- or higher) will triple (from 20% to 60%). • Differences in accounting rules across jurisdictions and sectors would impact on how the proposed risk drivers are calculated and would lead to comparability issues. • The use of absolute revenue as a risk driver also raises the	bias • Leverage benchmarks are biased towards industries which are efficient at low leverage (e.g. services industry is less asset intensive) compared to industries which are efficient at higher leverage (e.g. manufacturing); could it be refined by introducing three board industry categories of Services, Manufacturing, and Trade, each having their unique leverage benchmarks • We suggest Off Balance sheet exposures to be part of the leverage provide comprehensive picture (already used in credit analysis/spreadsheets). For ease of calculation, we recommend using notional off/balance sheet exposure values i.e. not based on CCFs, and should be benchmarked accordingly. • Use of external ratings, where available, for corporate exposures (bilateral lending, or exposures to capital market instruments) should be allowed. The proposed risk drivers should be used for risk discrimination of unrated corporate exposures.		• For senior corporate exposures, revenues and leverage are used as main drivers for deriving risk weights. Using revenue measure alone may indicate lower risk perception of companies with large revenues but possibly with low operating income, net income and cash flows. The Committee could consider other credit risk drivers such as cash flow from operations, total debt to EBITDA, etc. based on statistical analysis. To avoid impact of unusual financial conditions, the Committee can use moving averages on a 3-year or a 5-years basis. The leverage can include all the material off balance sheet assets arising from any special purpose vehicles, commitments and obligations of the firm.

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	concern about potential volatility of the capital ratios due to exchange rate variations. This would also pose a challenge in consolidating positions in countries where individual accounts are denominated in a currency that is different from the consolidated one. Any variation in exchange rates between the two currencies could potentially result in different capital charge, as the absolute value for determining the risk weight is different in local currency and in the consolidated one. • While leverage is clearly a primary risk differentiator, the proposed definition fails to recognize differences between accounting standards and business models seen in different industries (as alluded to above). Moreover, lower risk			

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	weights should be given to exposures to corporates with very low leverage.			
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 new proposal seems to penalize SMEs with sales < EUR 50 million by assigning risk weights from 90% to 130%. This is in contrast with the internal ratings-based (IRB) which gives preferential treatment to SME (sales < EUR 50 million) by means of firm-size adjustment to the correlation co-efficient. We believe this would introduce misalignment between the standardized approach and the internal ratings-based (IRB) approach which is contrary to the stated objective of increasing comparability of capital requirements under the standardized approach and the IRB approach by aligning definitions and taxonomy, where possible. • In many developing countries	• In principle SME incorporation in to “Corporate asset class” is fine; however the proposed range of minimum and maximum RW (100% to 130%, and 300% where financials not available) is considered excessive, and counterproductive, in the context of Polices in several Jurisdiction that encourage sustainable SME growth; therefore lenient treatment for, both, start-ups and established SMEs is recommended	• The proposed treatment seems to be appropriate.	• We also support a lenient treatment for startup companies where financial support is available to them from the government.

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	small businesses do not publish financial statements. In accordance with the proposed rules, this would mean the 300% risk weight would be applied to almost all of the small business portfolio. This not only affects banks but equally may have an impact on the access to, and cost of finance for small businesses; this could be a fundamental obstacle for economic growth.			
Q7. Do respondents think that the risk sensitivity of the proposal can be further increased without introducing excessive complexity?	• In the consultation document, the same risk weight is given to corporates with leverage in the 1x-3x range. One possible solution to further increase the risk sensitivity is to introduce more granular risk weight buckets in 1x-3x range.	• Simplicity should not be achieved at the cost of "inaccurate" or "biased" risk assessment. Having said that we believe comments and suggestions made under question 5 can further refine the proposal without adding complexity – once recalibrated.	• No.	• We believe that introduction of additional ratios will only add to complexity.
Q8. Do respondents agree that introducing the specialized lending category enhances the risk sensitivity of the standardized approach and its alignment with IRB?	• The treatment of specialized lending in the proposal seems to be insufficiently risk sensitive as it assigns a uniform risk weight. In contrast, under the current	• For risk sensitivity and comparability purposes, creating Specialized lending as a different asset class is acceptable, however: • The proposed design is not risk sensitive and RWs (120% and 150%) are excessive for all of the	• Yes. However, we feel that the project finance category should not have the floor of 120% as such projects are well structured and most of the time supported by the government and in general	• We concur with the suggested approach.

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	IRB slotting approach, risk weights depend on internal assessments. As such, we suggest to consider the IRB slotting approach and risk weights in the proposal. • The risk weights for specialized lending are punitive. We observe that the risk weights changed from 70%-250% to a uniform 120% or 150%.	identified sub-classes. • Regardless of real estate market conditions/volatility, value of collaterals involved in income producing real estate finance, and exposure to land acquisition has a positive impact on LGD and therefore such loans/exposures should not carry RW of more than 100%; current preferential treatment (of 50% RW under strict certain conditions) should also remain available. • For the remaining SL subclasses, we also recommend to use simple ratios, such as, forecasted average debt service coverage, debt to sponsors' equity, loan to value (for Object Finance only), and should be benchmarked accordingly. • Government sponsored development projects, and those supported by international development Agencies (EXIM banks etc.), common to emerging economies, should have preferential risk weights.	have lower LGDs (as recognized by some bank regulators). Furthermore, the RW for start-ups is being proposed at 110% while project finance is a better risk than start-ups.	
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	• No suggestions are available at this time.	• A key driver of the lower risk weight afforded to retail exposures is the lower correlation and systematic risk associated with these exposures.	• We agree to retain the 75% risk weight for Regulatory retail exposures and exposures to individuals that	• We support the criteria of individual exposures not exceeding 0.2% of the aggregate portfolio and

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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?		Unsecured retail exposures, credit cards, personal loans and overdrafts could be assigned different risk weights than those assigned to auto loans, mortgages etc. as the banks have the underlying assets as security. • Risk Weights must be based on product; Credit card has all different risk profile because of clean lending. • In general, other retail loans have assets as mitigants. • National discretion on granularity is highly recommend, including for exposures to small business that currently qualify for 75% risk weight.	do not meet all of the criteria for a regulatory retail portfolio would be categorized as "other retail exposures" be applied a 100% risk weight. • HNW and Private Banking individual lending should be confirmed to be a part of "Other Retail" category.	75% risk weight as suitable for regulatory retail exposures.
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?	• Conceptual issues and implementation challenges of using the proposed risk drivers for exposures secured on residential real estate: • We agree with the consultation document that "differences in real estate markets, as well as different underwriting practices and regulations across jurisdictions make it difficult to define thresholds for the proposed risk drivers that are meaningful in all	• We agree; studies have shown that the correlation between high LTV and DSC have resulted in delinquencies and defaults. The level of LTV and DSC are good predictors of loan default in a mortgage loan portfolio.	• We agree that LTV ratios have a better predictive power, however it would remain a challenge for implementing the LTV & DSC ratios for retail exposures.	• We believe that LTV and DSC ratios are the most important risk measures for such exposures, especially at the time of loan origination.

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	countries". As such, it would be quite challenging to interpret and compare the two risk drivers (i.e. LTV and DSC ratio) across jurisdictions. Hence, we propose to retain the existing 35% risk weight to owner-occupied residential real estate exposures.			
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.)	• Fixing the denominator of the LTV at origination dilutes the predictive power of the metric. A periodic "marked-to-market" LTV is a much more accurate metric to use. • The use of DSC calculated at origination is not risk sensitive, especially for long-term real estate loans where significant changes to the borrower's risk profile could occur during the life of the loan. On the other hand, calculating DSC ratio on a regular basis presents not only operational challenges but also privacy issues, since it	• The LTV and DSC will be established at origination of the loan but thereafter it will be very difficult to review on a continuous basis over time. • It should be at the origination as any new loan will consider its DSC; It will be difficult to treat revalue in continuous time span and there will be a challenge in terms of operations. We think that it can be considered across jurisdictions	• We propose to keep the value of property not constant as measured at origination in the calculation of LTV ratio and to be updated over the tenure of the loan.	• We concur that the value of the property should be based on the lower of the current market value and the market value at the time of origination. • We also believe that the DSC ratio be reviewed on an annual basis to assess the impact of changing market conditions on revenues/costs.

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	would require the bank to constantly ask the borrower for updated income and debt information. These issues should be considered by the BCBS in deciding on whether or not to use the DSC ratio.			
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?	Other issues with regard to DSC ratio: • There is no common definition, which complicates a cross-country evaluation • Difficulty in determining income for certain borrowers • Quality and reliability of data may not be consistent	• It will be very difficult to prescribe fixed thresholds for differentiating risks and extremely difficult to monitor across a retail portfolio. • As an alternative, it is suggested that threshold range(s) are established/prescribed with National discretion for the individual Jurisdictions to factor in the local peculiarities/conditions.	• Keeping in view of the response of Q.11, We suggest to differentiate the threshold by following categories: High, Medium & Low. for income that can be associated with DSC.	• We support the idea of differing risk weights based on a given threshold for the DSC. The proposal refers to a threshold of 35%. However, the current SAMA regulations for consumer finance provide for the maximum DSR/DBR of 33%. We therefore suggest a lower risk weight for DSR/DBR of up to 20% and a higher risk weight for DSR/DBR above 20% subject to SAMA's maximum ceiling of 33%.
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 have no comments at this stage.	• We have no proposals for any additional risk drivers that need to be considered.	• We do not see any other alternative drivers as of today.	• We suggest the additional use of tangible net worth/other debt (excluding the value of property being financed) as an additional risk driver.

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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?	• We believe that the value of the collateral should be taken into account in determining the appropriate risk weight for exposures secured by commercial real estate. As such, the second option would appear to be more preferable. On the other hand, the use of LTV ratio as a risk driver under the second option presents some concerns. Similar to the issues identified above for residential real estate, differences in real estate markets, underwriting practices, etc., make it difficult to define LTV thresholds that would be meaningful across jurisdictions.	• Use of LTV is a better option. • Furthermore, LTV at the origination may be used but the maximum RW in the range of the proposed RWs should not exceed 100% (i.e. recommend a range of 60% to 100%, depending upon the LTV).	• We consider Option A to be more relevant.	• Option A refers to treating the exposure as unsecured by assigning the counterparty (retail or corporate) risk weight ranging between 60% and 300% to the exposure and maintaining a national discretion for a preferential 50% risk weight under strict conditions. This assumes that the probability of repayment and the loss incurred in the event of default are most closely tied to the nature of the counterparty. • Option B refers to assigning a risk weight to the exposure from a table of risk weights ranging between 75% and 120% based on the LTV ratio. This assumes that the probability of repayment and the loss incurred in the event of default are most closely tied to the amount by which the value of the collateral exceeds the outstanding amount of the

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				loan. • In our opinion, option B would be more suitable.
Q15. What other options might prudently increase the risk sensitivity of the commercial real estate treatment without unduly increasing complexity?	• We have no comments at this stage.	• Continue with the current position; please refer to our comments under Question # 8, second bullet2.	• The current proposed methodologies appear to be adequate.	• We suggest the use of the Leverage Ratio.
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 have no comments at this stage.	• We agree that that a risk weight add-on should be applied to only retail exposures and exposures secured by residential real estate, based on the findings of the planned QIS.	• The proposed add-ons for currency mismatch in Retail and residential mortgages seem appropriate.	• Exposures where the lending currency differs from the currency of the borrower's income are subject to the risk of foreign exchange rate volatility which is a factor external to the borrower that affects its debt-servicing capacity. The proposal is to have a risk weight "add on" for retail exposures and exposures secured by residential real estate on the assumption that such borrowers generally do not manage or hedge their foreign exchange risk. • We do not agree with the proposal for risk weight

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				add-ons as we believe that non-corporate borrowers having exposures in foreign currency do manage/hedge their risks prudently similar to their corporate counterparts.
Q17. Do respondents consider the categories for which a CCF is applied under the standardised approach to be adequately defined?	▪ We believe that the definition of commitments in the proposal should maintain making the differentiation depending on maturities as defined in the current standardized approach. The proposal suggests using a uniform CCF of 70% for commitments which in our opinion is not risk sensitive. Hence, we propose maintaining the current treatment of 20% and 50% CCF depending on the maturity.	▪ Yes.	▪ Yes.	▪ We consider the categories for which CCF is applied as adequate.
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	We would like to note the following: • The proposed changes would have implications on the leverage and large exposure calculation. Hence, the impact of the proposed changes to these other two Basel	▪ Likelihood of the drawdown is not the function of instrument per se; it is the function of borrowers business needs through his business cycles. ▪ Change of CCF, from 0% to 10%, for Commitments that are unconditionally cancellable is very high, can significantly increase RWAs where facility utilization rates are low,	▪ Yes.	▪ We are unable to comment on this question as we do not have empirical data for analysis and review.

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	standards (not just on credit risk capital charge) should be considered. • The proposal to increase from 0% to 10% of "Commitments that are unconditionally cancellable at any time without prior notice, or that effectively provide automatic cancellation due to deterioration in borrower's creditworthiness" is unduly punishing for banks.	and would restrain banks' business promotion activities (most of the borrowers have multiple banks); it is therefore suggested that the proposal is withdrawn or revised downwards to not more than between 1% - as they can be cancelled without prior notice, any time. ▪ We also believe that upward revision of CCFs for Commitments not unconditionally cancellable (from 20% & 50% to 75%) is excessive and unwarranted, and should remain unchanged at their current levels. ▪ The proposed upward revision of CCFs for unused cancellable and non-cancellable facilities is likely to have significant impact on banks RWAs, and it is imperative that the proposed revisions are reconsidered in the light of suggestions made above. ▪ We further support our views by taking a portfolio perspective i.e. the unlikely scenario where all borrowers draw down on their unused facilities at the same time, in the same proportions.		
Q19. What are respondents' views on the alternative treatments currently envisaged for past-due loans?	▪ As with the current standardized approach, we believe the risk weight applicable for past-due loans should take into account the amount of provision. Hence,	▪ Any revision should continue to be based on the existing design; use of flat rate for all past dues is not recommended. ▪ We assume that current RW regime for Past Due exposures had been	▪ We prefer to keep the current approach.	▪ The existing approach of risk-weighting past-due loans more heavily than performing loans but allowing a reduction based on the amount of specific

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	we are not in favor of the proposal to consider applying a flat risk weight for all past-due loans.	calibrated on the basis of 45% LGDs for senior debt. Any future upward recalibration of RW should be based on empirical study.		provisions held is the appropriate approach in our view. We do not suggest the alternative proposals such as a flat risk weight for all past-due exposures, or an add-on to the applicable risk weight which may vary as a function of the amount of provisions.
Q20. Do respondents agree with the proposed treatment for MDBs?	• As with the current standardized approach and as recognized in the proposal, we believe the preferential treatment of applying 0% risk weight for "eligible MDBs" is appropriate. However, in our opinion, the treatment of exposures to "other MDBs" as corporate exposure is not fitting to the business models of MDBs. Hence, we support the Committee's consideration to use risk weights based on the external credit rating of the "other MDBs".	• We agree with the proposed criteria for "Qualifying MDBs. • Support structure/behavior behind MDBs is quite similar to banking sector, driven by objective to facilitate economies & infrastructure development for sustainable growth; and therefore they are comparatively closer to banks asset class (and not to corporate asset class). • "All other MBDs" should not be treated as corporate asset class, and as an alternative, a single RW can be proposed for them within the RW table for MBDs.	• Yes.	• We agree.
Q21. What exposures would be classified under "Other assets"? Is a 100% risk weight appropriate? (Please provide evidence where possible).	• We believe the current standardized approach classification of exposures under "Other assets" is appropriate.	• In our view existing paragraph 81 of Basel II framework is generally sufficient; however it is suggested that exposure to Regulatory capital instruments issued by banks or	• Current definition is comprehensive. No change is proposed. 100% risk weight is appropriate.	• Generally, other assets would be those other than cash and equivalents, loans and advances, placements and investments. A risk

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		security firms that qualify for T2 Capital but not deducted from the capital, as per Basel III capital reforms, should be allowed to be risk weighted as per the external credit rating of the issue or the issuer unless the loss absorbency provision is triggered.		weight of 100% for assets including office buildings, advance payments, etc., appears to be unnecessarily high. We would suggest a risk weight of 30% (the proposed minimum floor).
Q22. What are respondents' views on the above alternative ways to define eligible financial collateral?	• We don't see much difference between the proposed approach and the current standardized approach of using the external credit rating for senior debt securities. As recognized by the proposal, both methods would probably yield the same results.	• Alternative proposal to define eligible security as financial collateral, using the concept of investment grade, is considered appropriate in jurisdictions where external ratings cannot be used. • Notwithstanding the above, use of external ratings for eligibility of financial collateral should not be discontinued, and be left at National discretion.		• The proposal to supplement inclusion of unrated debt securities as eligible collateral in our opinion is the correct approach for countries such as Saudi Arabia where external ratings for many debt securities issued are not available. We therefore support the concept of 'investment grade' which is defined as a security where the issuer has an adequate capacity to meet its financial commitments for the projected life of the asset or exposure, the risk of default by the obligor is low, and the full and timely repayment of principal and interest is expected.
Q23. What are respondents' views on the recalibrated supervisory	• We have no comments at this stage.	• Generally recalibration given in Table 4 is acceptable, but will reduce, to		• Given the recent volatility in

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haircuts shown in Table 4?		some extent, the mitigation benefit from Bank securities as collateral		equity and fixed income markets, we believe that enhanced haircuts may be reasonable. We therefore support the introduction of granular maturity buckets. • We believe that in a country such as Saudi Arabia, where the number of fixed income securities issued locally and externally are comparatively low, the concept of 'investment grade' as defined in the document is a pragmatic approach. This will allow many more securities to become eligible for inclusion as collateral. • However, external references need not be completely eliminated from the haircut table but a suitable mapping table could be provided which will convert internally rated securities into equivalent externally rated securities.
What are respondents' views on how		• Although we do not conceptually		

Questions	Bank 1	Bank 2	Bank 3	Bank 4
to eliminate references to ratings from the supervisory haircuts table? What could be the implications of eliminating references to external ratings?		agree on elimination of external rating, when available, for haircuts (and also for obligor risk discrimination, eligibility of financial collateral etc.) – re comments under Question one (1), the only alternative is to use the RW/risk discrimination matrix prepared/calibrated on the basis of risk parameters/ratios proposed in this draft document.		
Q24. What are respondents' views on the proposed corporate guarantor eligibility criteria?	• We have no comments at this stage.	• The criteria seems appropriate.		• The current standardized approach allows the use of corporate eligible guarantors based on relevant external credit ratings when they have a lower risk weight than the counterparty. In order to reduce reliance on such ratings, the Committee has proposed to limit the eligibility to cases where there are no established economic relationships between the borrower and the corporate guarantor and allowing it only for parent companies, subsidiaries, and affiliate companies of the counterparty.

Questions	Bank 1	Bank 2	Bank 3	Bank 4
				• In our opinion, eligibility should be based on the credit worthiness of the corporate guarantor irrespective of any economic relationship unless such an economic relationship is so close that a default by the borrower will lead to the default of the guarantor.

OTHER COMMENTS

Bank 2

Exposures to HNW Clients:

- These defined exposures under the current STD Approach are treated as corporate and receive 100% risk weight (since not externally rated). In the revised draft proposal, we have noted that the proposed financial/risk indicators/Matrix for “corporate” i.e. revenue size and leverage ratio cannot be applied to HNW exposure type, and therefore will carry a RW of 300%. Bank considers that prescribed RW is excessively high needs to be addressed.
- Furthermore, and importantly, for developing country banks the proposed RW/treatment will be very penalizing since their Regulatory Authority have generally, so far, not allowed financial collateral to mitigate the obligor credit risk, although such type of exposures are generally on a highly secured basis (i.e. coverage is more than 100%). We therefore request the Agency to reconsider its current position on eligible collaterals.

Equity Exposures:

- Equity exposure under the current STD Approach rules receive 100% RW. However, the revised proposal calls for excessively high flat RW of 300% for traded equities, and 400% RW for non-traded equities. Such sweeping treatment needs reconsideration – especially for traded equities.
- We note that traded Equity exposures in the banking book are liquid investments and are already marked to market, and (Regulatory) capital is adjusted accordingly. Therefore, on a going concern basis, the capital requirements associated with the deterioration in the exposures is addressed.
- Furthermore, we believe that since PD/LGD approach is allowed for Equity exposures under IRB Approach, use of financial risk indicators such as revenue size and leverage should be a good proxy for the risk weighted/sensitive assessment of such exposures, rather than a flat Risk Weight regardless of the financial capacity and strength of the investee.

Emerging/Small companies without Financial Statements:

- Relevant to most developing countries, the proposed revisions would necessitate availability of financial information/data from smaller emerging companies as well (although start-ups would receive preferred treatment); in absence of financial information high RW of 300% will be used.
- Although most of such exposure is on secured basis, but in absence of collateral eligibility, most developing countries banks and local authorities will have to make concerted efforts to ensure availability of financial statements from smaller companies.
- Otherwise, given the required capital allocation banks’ credit extension to such market segment will decline which will be contrary to Policy objectives.

OTHER COMMENTS

Bank 4

We generally agree with the approach of the Committee to reduce reliance on external credit ratings which for many borrowers are not available in any case. Currently, exposures are risk weighted at 100% irrespective of differences in their relative riskiness. Introducing a look up table for a range of credit conversion factors (CCF) based on key risk drivers for borrowers is particularly suitable for small to medium sized domestic banks. The new approach would also be more risk sensitive, reduce national discretion, strengthen the link between the standardized approach and the internal ratings-based (IRB) approach, and enhance comparability of capital requirements across banks.

Introducing look up tables will result in other issues including the likelihood that ratios will vary between countries, and in the case of corporates, risk drivers such as revenue and leverage will also vary within countries for different industries/sectors. Furthermore, issues such as availability of audited financial statements on a timely basis will pose practical difficulties. In view of this, we believe that the lookup tables finalized by national regulators should take these into consideration.

We also note that apart from revenue and leverage, there are other relevant credit risk drivers including liquidity, profitability, operational as well as other industry/sector specific risks. In particular, we emphasize that defaults will generally occur due to lack of liquidity and we note that the BCBS has not proposed any liquidity measure as a credit risk driver. This issue should be reconsidered for inclusion in the framework.

With respect to the Credit Conversion Factor (CCF) for off-balance sheet items, including commitments that are unconditionally cancellable at any time without prior notice, or that effectively provide automatic cancellation due to a deterioration in a borrower's creditworthiness, we believe that the proposed CCF of 10% will impose a substantial burden on banks. Currently, whenever the commitments are unconditionally cancellable, a bank can treat the difference between the approved limit and the outstanding amount as 0% risk weighted. We therefore seek clarification of this new condition.

We agree with the approach of the Committee to revise the current framework which has weaknesses, including allowing the use of internal estimates for haircuts which is contrary to the principles being proposed for the revised standardized approach. We support the proposal which includes:

- Recalibration of the supervisory haircuts for issuers (other than sovereigns);
- Securitizations (which were revised by Basel III) when using the comprehensive approach;
- An increase in the number of maturity buckets for other issuers; and
- Applying higher haircuts to equity instruments.

Given the recent volatility in equity and fixed income markets, we believe that the proposal to enhance haircuts is highly relevant.

Risk weights Subordinated debt, equity and other capital instruments

As regards risk weights for equity exposures traded on public securities markets, the Committee proposes 300% risk weight. Equity securities are generally classified as available for sale securities. Based on the current accounting standards, equity exposures have significant provision norms and their profit and loss movements are recorded in other reserves on a daily basis. Although it is prudent to have higher risk weight for equity securities when compared to corporate or bank credit exposures, we believe 300% risk weight is stringent specifically for buy and hold investors with fundamental view and the investment objective is to generate higher dividend yield and longer term capital appreciation.

OTHER COMMENTS

Bank 5

Exposure to Corporate

- The stated objective of strengthening the link between Standardized Approach (SA) and Internal Rating Based (IRB) approach appears to be contradictory. The risk drivers suggested under SA may not be the good predictor of risk for all banks. Moreover, IRB models also have the added advantage of statistical validation on the bank's portfolio itself, and therefore, has better risk prediction power as compared to Revenue and Leverage ratio suggested in the document.

- The reliance on accounting data have its own shortcoming. In many countries, the accounting practices have not reached the level of sophistication, where one can fully rely on integrity of the audited accounts; and less so on the in-house accounts provided by the borrowers themselves. The variation in quality of the auditors can also hamper the objective of achieving the comparability across the jurisdictions as well as among the borrowers. Moreover, we are of the opinion that reliance on in-house financials may result in situations, where the banks may be able to lower the capital requirements, by manipulating the financials.

- Revenue and leverage criteria may not be appropriate for security firms and financial institutions that are treated as corporate under the new definition. These types of institutions are more leveraged as compared to normal corporates.

Exposure to Banks

- Risk drivers proposed for exposure to banks may not be relevant for newly established banks, as these banks may not have a meaningful CET-1 ratio for determining RWAs. We are of the view that a separate criteria needs to be developed for newly established banks on the same lines as proposed for start-up corporates.

- Under the existing standardized approach, individual banks cannot get a rating better than the rating of sovereign in which they are incorporated. In the proposed criteria, it is likely that many individual banks in countries with non-investment grade sovereign rating will score better than global banks in higher rated sovereigns. We are of the view that without incorporating country rating, the proposed criteria to determine Risk Weight may have inconsistencies in assessing the risk among banks.

- We are of the opinion that with the use of CET-1 is adequate and will provide a more conservative approach. Moreover, Leverage ratio may also be made part of the metrics. This will help in improving the risk sensitivity and provide a better assessment of the non-risk weighted asset profile of the banks.

- The methodology adopted by the banks to report NPA may vary across jurisdictions. In case of state-owned banks, NPAs may not be reported in a transparent manner in some jurisdictions. This will result in distorting the NPA ratios. It will, therefore, result in penalizing banks in other jurisdictions, where more stringent monitoring and reporting mechanisms for NPA are in place.

Exposure to Retail

- Regulations may consider removing the higher risk weight on residential mortgages, of the mortgage laws are in place now and banks portfolios have generally shown low defaults against the housing loans.

- The suggested Loan-to-Value proposal will have its operational difficulties due to reliance on external valuations as well as the consequent burden of additional costs, which will be added to the interest charged to the retail borrowers.

Exposure to Equities, Subordinated Debt and Capital Instruments

- Analysis/reasons which formed the basis of increasing risk weight on these type of exposures have not been made available in the document. Increasing risk weight on subordinated debt exposures may restrict banks' avenues to raise Tier 2 capital, and thus resulting in higher cost of capital for the banks.

Unconditionally Cancellable Commitments

- Increasing CCF on such commitments from 0% to 10% appear on a higher side. We are of the opinion that CCF % should only be increased for commitment against overdraft facility due to its readily available nature. For commitment against other type of facilities, CCF should be kept at 0%, as banks generally have adequate mechanism to cancel such commitments promptly and without recourse to the borrower.

General

- Although detailed impact of proposed amendments in Standardized Approach on Saudi banks cannot be assessed at this stage, however, initial analysis indicate that changes will possibly result in increasing RWAs due to higher proposed Risk Weights for equity exposures/subordinated debt exposures/small business corporate exposures (where leverage and revenue information is not available) and increase in CCF for unconditionally cancellable commitments. Therefore, we are of the opinion that prolonged parallel run period is necessary of existing and proposed approaches before deciding on new set of guidelines.

- The minimum capital floor based on capital adequacy calculated under standardized approach will also result in lesser incentive for the banks to invest in IRB approaches, which in the past has contributed towards enhancing he credit risk management capabilities of the banks. This will consequently have adverse impact on bank's risk management practices.

The document states its objective to move away from the reliance on external ratings. However, under the comprehensive approach of risk mitigation (para 108), all the securities are still assessed on the basis of the external ratings. This is contradictory to stated objectives of the Committee. Moreover, Credit Valuation Adjustment (CVA) methodology rely on external ratings for determining weights of OTC derivatives counterparty.

OTHER COMMENTS

Bank 6

The desire of the BCBS to reduce the reliance on external ratings, reduce national discretion and increase the risk sensitivity of the capital calculations is recognised and supported. However, the scale of the challenge to devise a globally consistent approach should not be under estimated given differing local market dynamics and risk drivers.

Whilst increasing the overall capital requirements is not a direct objective of the review it is clear that the revised approach will see an increase on Pillar 1 capital requirements for credit risk across a number of segments:

- For Banks the lowest risk weight will increase from 20% to 30%.
- For Corporates the risk weight for companies with no or outdated financials will increase from 100% to 300%. Whilst we fully support the timely availability of financial information from borrowers, we need to ensure such RWA penalties are appropriate to the circumstances.
- There will be new categories for specialist lending and changes in credit conversion factors, particularly the 10% (previously 0%) for unconditionally cancellable commitments.
- For Retail portfolios there is a tightening of the eligibility criteria for applying the 75% risk weight and the Residential mortgage risk weight will increase from 35% to a range from 25% to 100%.

For the Bank, these changes would mainly result in a movement of existing capital allocations for credit risk under Pillar 2 to Pillar 1, however it is recommended that a full quantitative impact assessment is undertaken to ensure there are no unintended consequences arising from the revised approach.

From an infrastructure perspective, the shift away from external ratings will require significant investment in changes to systems, risk engines and reporting templates which will need factoring into the lead times for deployment of the final regulations.

The application of capital floors will increase the comparability of capital adequacy ratios across banks, providing a more transparent view for external bond and equity investors as well as providing equality of treatment for banks, whether using standardised or advanced approaches, across customer segments and product categories.

OTHER COMMENTS

Bank 7

Revision to the Standardized Approach for Credit Risk

1) Banks:
   a. While we recognize the stated goal of reducing reliance on external ratings for the purposes of assigning risk weights, we firmly believe that the detailed analysis of both quantitative and qualitative data undertaken by the rating agencies cannot be substituted by just two risk drivers.
   b. The use of the CET1 ratio as a risk driver assumes that all banks will have transitioned to Basel III by the time of implementation -given the slow current rates of adoption, this may prove to be difficult to achieve.
   c. Rules have not yet been proposed for subsidiaries/branches forming part of larger financial entities. Issues may include:
      i. do local regulations applicable to a foreign branch supersede those of its holding company?
      ii. If a subsidiary has not yet transitioned to BIII can the holding company ratios be used?
      iii. how do we treat branches which have no local capital requirements etc.
   d. Banks are penalized (300% RW applied) if the Pillar 3 information is not published in time – this can lead to large distortions/variations in RWA for this asset class between reporting periods. A one notch downgrade from their last assigned risk weight (which would have been based on their last published Pillar III disclosures) might be a more appropriate option.

2) Corporates:
   a. We welcome the recognition of a more risk sensitive approach to the risk weights currently applied to corporates.
   b. Using global measures as risk drivers could however be problematic when being applied across jurisdictions due to the different sizes of economies e.g.. A large corporate could be defined as revenue > EUR 100million in one geography, whereas EUR20 million is considered large in another. This may be addressed through an additional dimension of an economic measure such as GDP, coverage (exposure/revenue) etc.
   c. Allowing regulatory discretion (based in local data) for the Revenue / Leverage thresholds as well as corresponding risk weights might be a more appropriate option.
   d. Other measures which have been identified through our own quantitative analysis as being good indicators of risk driver for corporates include asset size, liquidity and coverage.
   e. Banks are penalized when the financial statement information required is not made available (300% RW), and this can cause large distortions in RWA.
   f. Given the changes being considered / proposed for the definitions of Corporate and Retail exposures, SAMA will have to provide more clarity on the definition of HNWI asset class.

3) Exposures secured by residential real estate
   a. Some regulatory discretion may be required for those jurisdictions which do not have a mature legal framework for mortgages in place.
   b. Per the last paragraph on page-15: "… the Committee is considering requiring the value of property to be kept constant at the value calculated at origination. Thus, the LTV ratio would be updated only as the loan balance (i.ee the numerator) changes." It may be more prudent to revalue the property at a regular frequency and update the LTV ratio using the new value to reflect the correct risk of default. Similarly, the Debt Service Ratio (first paragraph on page-16) should also be updated at a similar interval.

4) Past due exposures
   a. The maximum risk weight applied to past due exposures remains unchanged for the moment at 150% - this appears to be at odds with the fact that banks will be expected to apply a 300% risk weight to corporates who have failed to provide their updated financial information. We would expect that the risks associated with actual past due obligations are higher than those associated with a procedural oversight on the part of the obligor.

5) Off-balance sheet exposures
   a. The 10% credit conversion factor (CCF) proposed for unconditional cancellable commitments do not appear to be supported by any empirical evidence to quantify the percentage.

6) Other assets.
   a. It is not clear whether other assets includes current categories which receive a lower risk weight e.g. cash, items in the course of collection etc.

7) General
   a. A large number of additional data points will need to be maintained and system enhancements are required to be made to the respective capital calculation engines – banks should therefore be given sufficient time to implement these changes before the implementation deadline.

OTHER COMMENTS

Bank 8

The following are the key points and the pros and cons of the proposal:

Key Points:

- **Corporate exposures** – replace external credit ratings with two risk drivers: the revenue and leverage of the borrower, to determine risk weights ranging from 60% to 300%.
- **Residential mortgages** – determine risk weights by two risk drivers: loan-to-value and debt-service coverage ratios, with risk weights ranging from 25% to 100%;
- **Other retail** – tighten the criteria to qualify for the 75% preferential risk weight;
- **Commercial real estate** – two options here: (a) to treat these as unsecured exposures to the counterparty, with a national discretion for a preferential risk weight under certain conditions, or (b) to determine risk weights on the basis of the loan-to-value ratio, with risk weights ranging from 75% to 120%;
- **Banks** – replace external credit ratings with two risk drivers: the capital adequacy ratio and an asset quality ratio of the borrower, to determine risk weights ranging from 30% to 300%;
- **Credit risk mitigation** – amend the framework by reducing the number of approaches, recalibrating supervisory haircuts, and updating corporate guarantor eligibility criteria;
- **Sovereigns, central banks and public sector entities** – no changes at this stage, pending a wider review of sovereign exposures.

Pros and Cons:

Pros

- Less reliance on external ratings as risk assessment will be country and obligor's specific;
- Alleviating and aggravating factors such as quality of assets, revenue and several other ratios usually used in credit analysis will be considered. This will align the actual practice vis-à-vis supervision;

Cons

- The proposal will result to a higher capital requirements due to increased risk weights;
- The access to the obligors updated and most recent information will be a challenge;
- Change management related issues such as existing risk management systems (tools), whether in-housed or outsourced, requires upgrades.