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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

baselcommittee@bis.org

11 March 2016

Dear Sir / Madam,

Revisions to the Standardised Approach for credit risk.

Formed in 1952, Secure Trust Bank PLC (STB) is a long standing UK retail bank. It provides Business and Consumer (Retail) customers with loans, savings and basic current account products. Like many small UK banks STB required no direct or indirect support to safely weather the global financial crisis. Indeed STB was the first bank to list its shares via IPO on the UK Market post the crisis in 2011.

STB supports the principle of the Basel Committee ('the committee') reviewing the standardised risk weighting to establish if the current approach is optimal and to explore how the huge, arguably anti-competitive, capital advantages enjoyed by the systemic firms can be reduced. The small non-systemic banks can be easily resolved in the event of their failure whilst causing no significant risks yet are required to hold disproportionately high levels of capital in respect of credit risks because their modest size means they do not have the resources to meet IRB requirements.

The huge disparity between the capital requirements of banks operating under the IRB model and those on the standardised basis has created a very distinct two tiered banking system. The top tier is made up of the systemic 'Too Big to Fail' banks which are sustained by their funding, capital and incumbency advantages. The lower tier comprises small banks that, in aggregate, have a lending portfolio which is higher than average risk because they cannot compete, on a sustainable economic basis, for lower risk mortgage or lower risk SME lending assets. Small bank balance sheets inevitably reflect where they can currently compete relative to the dominant incumbent banks. The appendix attached clearly shows that it is economically impossible for smaller UK banks to compete for 50% LTV owner occupier or buy to let mortgages. Many small banks, including ourselves, would love to diversify and derisk our balance sheets by undertaking more low risk, low LTV lending but cannot effectively compete with the systemic banks.

The first consultation paper stated that the committee was not seeking to increase the overall amount of capital held by banks using the standardised risk weights. However the calibrations detailed within the second consultation paper will dramatically increase the amount of capital required to support virtually every class of lending asset. At the aggregate level I believe the proposals, as currently written, could have profound and damaging economic and societal consequences caused by a dramatic contraction of the supply of credit by those firms using the standard model.

We have contributed very fully to the comprehensive submission by the British Bankers Association (BBA) so I will not repeat those views here. I would however like to highlight some key concerns / observations.

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Proposed changes will stifle competition and potentially increase risk in smaller banks

Changes that result in the standardised banks becoming even more uncompetitive relative to the systemic banks will perpetuate and compound the too big to fail situation that exists in many countries. By making it even more difficult for small banks to compete with the dominant banks for lower risk lower LTV lending assets the committee could force these banks to move to higher risk higher margin lending to compensate for higher capital costs. It would seem very perverse if steps ostensibly designed to reduce risks in the banking sector actually served to herd smaller banks even more into the higher end of the credit risk spectrum than the current advanced versus standardised capital dynamic already does.

I also note that the apparent direction of travel of the committee seems at odds with initiatives across Europe to create a more level competitive playing field by taking a more proportionate approach to the regulation of smaller banks. Only yesterday the European Central Bank slashed interest rates and increased the price commercial banks pay to it for placing overnight funds on account. These measures are to encourage lending across Europe. The new calibrations proposed by the Committee will stifle not encourage lending.

Increasing risk sensitivity in the standard model is logical and supported

I support the Committee's objective to improve the risk sensitivity of the Standardised approach to Credit Risk. This is important for the risk-based capital framework so that the capital banks hold against their exposures reflect the risk of loss.

A risk sensitive approach should, by definition, take into account all of the factors taken to reduce risk. So for exposures where significant levels of security are held, the capital requirements should be calibrated to appropriately reflect the credit risk mitigation undertaken. This will encourage banks to perform such risk-reducing activity. This is particularly the case for real estate lending, where the value of the property security and other risk mitigants should be considered in the risk weight specified for such exposures rather than simply treating all types of real estate finance as the same for risk weighting purposes.

Unconditionally Cancellable Commitments (UCC):

We note the proposal to restrict the definition of UCC, which will attract a CCF factor of 10-20%, to retail commitments only and that commercial commitments will fall into a new category of general commitments, which remains to be defined. We do not agree with the removal of UCC conversion factors to non-retail commitments where both legal and practical considerations allow for cancellation.

It is common practice within the Asset Finance and Invoice Finance product lines that customers have undrawn capacity against their facility limits. However, these limits can be varied at any time and at the sole discretion of the lender. As such these undrawn facilities do not represent any commitment by the lender to make further advances and as such should not be captured by any definition of General Commitment, which may necessitate capital to be allocated via a CCF.

If left unchanged the current proposal will have huge implications for Invoice Finance which is an important source of finance for smaller businesses. A customer will typically have a credit limit but the bank has the ability to determine whether or not to lend against any particular invoice. As such it is excessively punitive to require more capital to be held against the undrawn element. Any increase would directly impact on SMEs and their financing costs. The users of Invoice Finance tend to be SMEs who growing their businesses and therefore least able to pay more for their borrowing. Bankers use Invoice Finance because the ability to pick and choose which individual invoices for financing gives the complete control of their exposures. For this reason Invoice Finance losses as a percentage of lending has tended to be quite low.

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Therefore our view is that the 'General Commitments' category should be defined to exclude undrawn facility balances where there is no contractual or implicit commitment on behalf of the bank to advance further funding.

Exposure to SMEs

We agree that a lower risk weight for SME entities is appropriate and this is provided for within the proposed guidance. However what is not mentioned within the consultation paper is how this proposal would interact with the existing SME Supporting Factor. The introduction of a SME specific factor within the guidance may be taken as implying that the SME Supporting Factor would not be applied in addition, however any withdrawal of this factor is not mentioned within this proposal nor by other issued guidance. Therefore clarification of the status of the SME Supporting Factor is requested. We also suggest that the SME risk weight should be factored by the value of any tangible risk mitigation in place such as deed security.

Residential Mortgage and Buy to Let lending

We completely endorse the submission from the BBA in respect of these classes of assets and fully support their proposals. We do not agree with the Committee's view that Buy to Let lending is substantially more risky than the financing of owner-occupied residential property, in our view the risks are not dissimilar.

Acquisition, Development and Construction (ADC)

The proposed definition of ADC is drafted widely, to include not only genuine construction projects from the ground up but also the acquisition of finished property, all lending falling into this category attracting a risk weighting/CCF of 150%. This looks like a very unscientific and blunt approach to what can be a source of safe and remunerative lending. With populations in many countries continuing to grow and governments committing to build appropriate properties to adequately house their citizens it is important that the Committee does not exercise excessive caution which serves to prevent standardised banks from supporting modest loan to value residential property construction.

We acknowledge that some forms of ADC are speculative and higher risk in nature. In practice this tends to be commercial real estate lending. Commercial property lending with no clearly defined repayment source, where the inherent value of the underlying asset could range from zero for an unlet commercial unit to a high value if let to a blue chip tenant, should attract a higher risk weight.

By contrast the provision of loans at LTVs of say 75% or less to proven housebuilders to construct residential properties in areas with a clear shortage of housing is manifestly not speculative lending and should be risk weighted accordingly. A 100% risk weight seems suitable conservative for such lending

The BBA has proposed a protocol that seeks to reflect the relative riskiness of different types of ADC finance and I fully endorse their proposals in this respect.

***Real** Estate Off-Balance Sheet Exposures*

The definition of off-balance sheet exposures, as further defined in Annex 1 paragraphs 64 to 74, suggests that a new single CCF rate for real estate off balance sheet exposures is still to be defined within the range 50-75%, as compared to 50% under current guidance. It is understood that further proposals will follow once the results of the current QIS exercise have been analysed. However our view remains that there is no commercial justification to depart from the current 50% CCF, which we feel adequately reflects the inherent risk in this area.

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In summary, we support a review of the standardised approach but respectfully suggest that proposals outlined in the Committee's consultation paper require very substantial revisions if profound and damaging consequences are to be avoided.

Yours faithfully,

Paul Lynam, ACIB, AMCT, Fifs
Chief Executive Officer

Basel Committee standard risk weight changes proposed 10 December 2015

The table below highlights that on a like for like basis the smaller UK banks using the standardised capital model need to hold dramatically more capital than the largest banks which use the advanced (IRB) method. This is not a UK specific issue. A similar picture exists in other EU states and it has huge implications for the provision of credit across the EU.

The current disadvantages suffered by the thousands of small banks across the EU will become much worse if the proposal announced by the Basel Committee on Banking Supervision in December comes to pass. This would hamper economic recovery in the EU as the smaller lenders will need to stop or reduce new lending activity because they have to hold significantly capital. It is also inevitable that the cost of credit will increase materially to reflect any increase in capital requirements. This seems at odds to the EU's desire to stimulate the EU economy by for example using negative interest rates to encourage banks to lend.

	Current situation			**Proposed new situation**		
	Current Standard risk weights%	Average IRB weights %	IRB capital required versus standard	Proposed standard risk weights %	Change in standard risk weight	IRB capital required versus new standard RW
Mortgages – Prime						
<50% LTV	35	3.3	- 960%	30	-14%	-809%
<60% LTV	35	5.1	- 586%	30	-14%	-488%
<80% LTV	35	10.8	- 224%	35	0%	-244%
<90% LTV	36	18.4	-96%	45	+25%	-145%
<100% LTV	43	31.4	-37%	55	+28%	-175%
Mortgages – BTL						
<50% LTV	35	3.5	- 900%	70	+100%	-1900%
<60% LTV	35	8.2	- 326%	70	+100%	-753%
<80% LTV	35	17.5	- 100%	90	+157%	-414%
<90% LTV	36	32	-13%	120	+233%	-275%
<100% LTV	43	43.1	0%	120	+179%	-179%
Lending to house builders	100	77.1	-29%	150	+50%	-94%
Large Corporate	100	54.1	- 84%	100	0%	- 84%
Mid Corporate	100	79.0	- 27%	100	0%	- 27%
SME Lending	100	77.1	- 29%	100	0%	- 29%