

**BASEL COMMITTEE ON BANKING SUPERVISION
SECOND CONSULTATIVE DOCUMENT
REVISION TO THE STANDARDISED APPROACH FOR CREDIT RISK
Asociación Española de Banca (AEB)**

The Spanish Banking Association (AEB) welcomes the second consultative paper on the revision of the Standardised Approach for Credit Risk and does appreciate the opportunity to provide arguments on the different issues included in the Consultation Document. AEB, a member of the European Banking Federation (EBF), has participated in the preparation of EBF's response to this consultation and fully shares its main messages. Notwithstanding that, AEB has prepared its own response in order to underscore those issues of particular relevance for Spanish banks.

As a general comment, AEB wants to emphasize that a **more granular approach should be considered** through the whole proposal.

Comparability and simplicity are without any doubt legitimate objectives but they should not be defended at expense of accuracy. Accuracy of risks measures will without any doubt help to enhance sensitivity and to provide a true and fair view of entities risk profiles.

Nowadays different operations are studied by entities in a very specifically manner due to high costs of capital, and we propose this way of performance to be reflected by Basel Committee in the standardized approach for credit risk.

The emphasis on **risk sensitivity** is also particularly important as the BCBS capital floors proposal of December 2014 suggested that standardised approaches would be used as the basis of a floor on capital requirements and the BCBS has announced that internal models could even be disallowed for some portfolios. Consequently, the greater risk sensitivity facilitated by modelled approaches could be lost or effectively "overridden" through floors and replaced by the much reduced risk sensitivity provided by standardised approaches. As such, the risk sensitivity and the new calibration of the revised credit risk standardised approach could impact both banks currently using the standardised approach and those using IRB modelled approaches. This makes the design and calibration of the standardised approach for credit risk extremely important. In this vein, we are very much supportive of the **comprehensive QIS** announced by the Committee, provided it is meant to comprise in a single exercise all kinds of risk in order to determine their combined impact on capital requirements and proceed to recalibrate where need be.



Exposures to Banks

- (i) AEB proposes the treatment for short term interbank exposures to be defined for maturities shorter than one year. This would align the treatment given by liquidity requirements and would be consistent with “short term” defined by credit rating agencies.
- (ii) The proposals would result in higher risk weights for the exposures to unrated banks in countries with sovereign rating, should the option to determine the risk weight of those banks on the basis of the sovereign risk be abolished. Therefore we believe that this option should be maintained. In some markets relative small entities play an important role and the cost of obtaining an external rating would be disproportionate. There is no evidence of the need to treat those banks in a stricter way than the current framework.
- (iii) Regarding covered bonds, separate and more favourable risk weights should continue to be assigned given that the risk profile is quite different from the risk profile of the issuing bank. The historically low level of losses in the covered bond market should be recognized:
 - Covered bonds are governed by specific legislation that fulfils a number of strictly defined criteria.
 - Covered bonds are particularly important for banks as they are eligible for liquidity reserves in respects of prudential liquidity requirements (the LCR). It is important that the costs of carrying large liquidity reserves are not unduly high, which they likely would become if covered bonds exposures are treated as other bank exposures.
 - While the covered bonds play a very significant role in the European financial system, similar markets are also developing outside Europe, thus calling for a global stance. In our view it is very important that covered bonds issued by a credit institution in jurisdictions with specific covered bonds legislation that fulfils certain strictly defined criteria, may continue to have a preferential risk weight treatment.
- (iv) The proposal penalizes groups with subsidiaries in third countries that are not Basel compliant (above all in respect of the treatment of exposures to banks). The definition of a bank is still related to the Basel accord. Even if the Basel accord has been implemented, local implementation usually includes deviations from international standards (in some cases, some jurisdictions only apply parts of the Basel standards). It is not clear how the application of Basel framework will be measured
- (v) The requirement for securities firm and other financial institutions (*“...provided that these firms are subject to prudential standards and a level of supervision equivalent to those applied to banks (including capital and liquidity requirements) and the risk drivers used to ascertain the applicable risk weights (or the information to calculate them) are publicly*



disclosed...) would leave a number of institutions out of the scope of this category of exposures, therefore being subject to the treatment of corporate exposures instead of bank exposures.

Indeed, **the prudential standards and supervision required** for these institutions would imply that securities firms and other financial institutions would be subject to **stricter requirements than the established for banks**. For instance, the liquidity requirement is a binding standard for securities and other financial institutions whereas for banks this requirement is not considered binding (it depends on the determination of the national supervisor). Therefore, **we suggest to align the prudential standards required for securities firms and other financial institutions with the ones required for banks**.

- (vi) The proposed government support carve out in banks ratings is very problematic in terms of current rating agencies disclosure, standards and methodological differences. Consequently, we think it should be discarded.

Exposures to Corporates

- (i) As stated in the General comment, a more granular approach is suggested. Exposure to Corporates, in particular unrated corporates is a clear example for this.

Corporates with no rating accumulates around two thirds of the total bank exposure to European companies. It is imperative to put in place a solution along these lines:

- To assign a 75% risk weight to exposures to unrated corporates that comply with the conditions set for the category of investment grade in the Standardised Credit Risk Assessment Approach (SCRA);
 - To assign an 85% risk weight to exposures to unrated corporates that would be classified as grade B according to the SCRA.
- (ii) The RW of corporate SME should be lower than the proposed 85% in order to take into account the idiosyncratic nature of the SME lending.
- (iii) We would support the creation of a subcategory for revolving credit lines, with a more favourable risk weighting in order to offset the penalization they will receive with the proposed hardening of CCFs.

Specialised lending

- (i) This asset class remains among the most negatively affected, while it should definitely be the opposite: the capital burden should be cushioned to encourage the relaunch of the real economy.

Indeed, we consider necessary to further **incentivise** project finance by **introducing a preferential capital treatment for this type of financing with lower capital requirements**



and a better recognition of the risk associated with these projects. Indeed, it is necessary to ensure adequate levels of funding for all forms of long-term financing for the economy, especially for infrastructure and other investments that support long-term growth. This would avoid undesired effects such as the crowding out of financial institutions or their movement to riskier projects to obtain the necessary profitability to meet their cost of capital

- (ii) We disagree with the double risk weighing in project finance (pre-operational and operational phases), while supporting a slotting criteria approach. Furthermore, a 150% risk weight approach for this asset class is considered with any doubt excessive, putting it on the same ground as past due exposures.
- (iii) The Basel Committee is expected to take into account the peculiarities of this segment. In this regard, collateralization and relating guarantees structures widely used thereon should be recognised.

Retail Portfolio

- (i) Another example of a more granularity needed is the absence of a particular category for credit cards in the current proposal. Recognised in IRB models, the same should be recognized in the CRSA, with specific risk weights.
- (ii) Moreover, we propose to take into account additional drivers (maturity, behaviour and length of the relationship with the customer,...) in order to enhance the risk sensitivity and again to align with the treatment under de IRB approach.

Residential Real State

- (i) AEB wants to support the option of Loan Splitting (LS) versus Whole Exposure (WE) in the allocation of Exposure At Default (EAD) to Loan To Value (LTV) buckets. It can be argued in favour of LS that:
 - It avoids cliff effects as marginal increases in LTV would lead to disproportionate increases in RW;
 - There is an undesirable incentive to split the loan between different entities in case that the LS option is not recognised.
 - Furthermore the AEB defends that the value of the property should be regularly updated to account for changes in the market value and make the LTV factor more risk sensitive.
- (ii) AEB believes that more granularity and better risk weights in lower levels of LTV (below 40%) would be warranted and simple.



Risk weight add-on for exposures with currency mismatch

- (i) We think that the approach to exposures with currency mismatches is not developed enough for the case of corporates, where the casuistic may be extremely diverse not to be treated as a simple comparison of loan and income currencies. We therefore think that corporate should be kept out of this regime.
- (ii) As to the flat “*add-on*” approach, we believe that it is not risk sensitive and could lead to unintended consequences. The adjustment should in our view not be additive, but rather a multiplying factor directly proportional to the original risk weight of the operation.

Treatment of past due

Provisions should be considered not only in order to calculate net exposures but also to assign the risk weights, which should in our opinion be lower for those operations with higher coverage ratios.

Off-balance sheet items

- (i) Credit cards should have a CCF of 0% as long as they are unconditionally cancellable commitments, so some segmentation might be considered if needed.

Other unconditionally cancellable commitments should have a preferential treatment provided they have the required clauses in their contracts.

- (ii) For off- balance sheet items we would like to suggest to maintain the current approach of different treatment for maturities of up to one year and above one year.

Credit risk mitigation (CRM) techniques

- (i) It is inconsistent that CRM, which is eligible in the IRB approach, is not eligible for the SA approach. Credit risk management and application of credit risk mitigation techniques are part of core banking activity and subject to strict operational and legal requirements and it seems inconsistent with the aim of making the SA more risk sensitive that collateral subject to prudent valuation and legal requirements is not recognised.
- (ii) Moreover, the framework should recognise the risk mitigating arrangements included in certain retail transactions, such as loans collateralised by durable goods (e.g. reservation of title in financing vehicles), and in corporate exposures (ships, airplanes financing).