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

11 March 2016

**RESPONSE TO SECOND CONSULTATION ON REVISIONS TO THE STANDARD
APPROACH FOR CREDIT RISK**

Dear Mr. Coen,

We are pleased to provide our comments on the second consultation on *Revisions to the Standard Approach for Credit Risk*, as we fully support the Basel Committee on Banking Supervision's ("the Committee") objective to balance simplicity and risk sensitivity, and to promote comparability by reducing *undue* variability in risk-weighted assets across banks and jurisdictions.

The revised proposal for the revisions to the Standard Approach ("STA") for Credit Risk is a positive development, which we believe requires further refinements to ensure a risk-sensitive approach at par with the internal models based approach.

We see an important role for Quantitative Impact Study ("QIS"). It is also critical to gain a clear understanding of the aggregate impact of the various changes in light of the Committee's objective not to have significant capital increases.

We believe sufficient time should be given to both regulatory bodies and industry to understand the implications of the changes proposed in this consultation as well as the interplay with the other planned changes to the capital and liquidity frameworks.

Use of External Ratings

We fully support the re-introduction of external ratings for purposes of risk-weight determination for exposures to banks and corporate. However, we would suggest:

- A revision of the risk-weights in light of the QIS to ensure comparability between the Standard Approach and the model based approaches;
- Not to exclude the sovereign ownership / support for purpose of risk-weight determination. This would allow for consistent consideration of sovereign ownership / support for internal assessment; and
- To consider the unintended consequences and divergences resulting from the proposed "due diligence" across banks and jurisdictions. If not carefully designed the guidance could achieve the opposite result in terms of comparability.

We seek clarification regarding the use of the parent rating for other entities within the corporate group. We believe that this could have knock-on effects especially for multinational corporate groups.

Proposed Revisions to Risk-Weighting and Credit Conversion

We would encourage the Committee to ensure that any calibration of risk-weights and other factors (like credit conversion factors) is carried out in a manner that appropriately considers the underlying risk.

- **Residential Real Estate Exposure Class**, the risk-weights for residential mortgage portfolio should be revised as the gap to internal model based risk-weights appears unnecessarily large and punitive, even after consideration of modelling constraints.
- **Commercial Real Estate Exposure Class**, additional risk-weight bands should be considered to more accurately capture the different risk profiles.
- **Loans fully secured by residential properties** should be exempt from the requirement that the property must be a “finished property”. In principle, the risk-weight for qualifying mortgage loans as defined in paragraph 54 should be applicable for these, too.
- **Loan-to-Value Ratio**, where national supervisors require banks to perform periodic property value adjustments, we would propose that the restriction on upward adjustment of property values be removed. This would facilitate the use of statistically proven methods for revaluation.
- **Corporate Risk-Weight Differentiation**, the risk-weight BBB corporate exposure is proposed as 100%, which is the same as for BB. As BBB is likely to have better credit quality than BB, the risk-weight for BBB corporate exposure should be revised between 50% and 75% in order to apply a more risk sensitive framework.
- **Risk-Weight for SME**, we strongly agree with the application of a reduced risk-weight, however, we propose to align risk-weight to the 75% risk-weight assigned to SMEs in the regulatory retail exposure class. This would improve simplicity and reduce arbitrary differences for SME exposures.
- **Credit Conversion Factor for Unconditionally Cancellable Commitments**, we consider the proposed conversion factors as unnecessary punitive. In line with the 2006 accord, such commitments should receive a 0% credit conversion factor.

Proposed Treatment of Currency Mismatch

The proposed add-on appears too punitive and simplistic without differentiating the various risk drivers. Generally more stringent credit criteria are applied by banks to manage foreign currency risk.

We would suggest a lower add-on (e.g. 10%) where the bank has applied a prudent discount on the foreign currency income in the credit assessment of the borrower's ability to repay.

Implementation and National Discretion

In our view, it is important to ensure that the pace of adoption of the new rules is consistent across jurisdictions to ensure a level playing field for all industry players.

For that, it appears imperative to reduce the opportunity for national discretion on qualitative requirements, risk-weights and implementation timelines to ensure consistency. The industry should be provided with adequate transition timelines of at least two to three years.

Summary

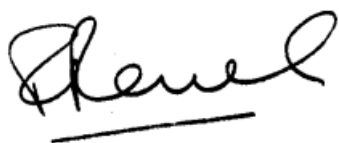
We appreciate this opportunity to provide our comments on the consultative document, also refer you to Appendix 1 which contains specific comments on selected paragraphs.

We would also like to refer the Committee also to the technical comments and recommendations reflected in the responses of the Institute of International Finance and the British Bankers' Association to which we have contributed.

We believe that a capital regime which relies on capital floors, if not supplemented with a flexible opt-out mechanism from internal model approaches, would not result in an efficient investment of risk modelling resources. In principle, the use of capital floors could lead to regulatory arbitrage, i.e. pushing low risk assets off the balance sheet while keeping high risk assets to help drive up returns.

We would be pleased to discuss the contents of this letter, and related matters, with you at your request.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Renel', with a horizontal line underneath.

Roselyne Renel
CRO, Europe & Americas /
Global Head, Enterprise-Wide Risk Management

Appendix 1 – Specific Feedback

SME definition (Paragraph 37)

“SME is defined as where the reported sales of the consolidated group of which the firm is part of is less than EUR 50m.”

We agree that sales turnover should be the key driver for defining SME. However some guidance and flexibility is required on the sales turnover information.

Change proposed:

- Annual sales turnover not exceeding EUR 50m (instead of less than EUR 50m). This is consistent with Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises.
- The use of computed annual sales turnover for the “entity” should be allowed. Smaller SMEs may not be required to file audited financial statements in certain jurisdictions.
- Institution should be allowed to rely on customer’s declaration for sales turnover of the consolidated group. SME structures are not as transparent or formalized as larger corporates. It would be difficult for the institution to request for financial statements (which may not exist) for the consolidated group when the credit assessment is based on the entity’s repayment capability.
- It is proposed that the EUR 50m sales turnover is only required at loan origination and there is no need for periodic update. It would not be possible to obtain updated annual sales turnover information for installment loan products and for smaller SME which are not subject to “manual” annual review process. (If there is a requirement to periodically validate the sales turnover, proposal is to exempt smaller SMEs e.g. with sales turnover of EUR 20m; unless there is an increase or renewal of the facilities.)

Real Estate Exposure Class (Paragraph 50)

“To apply the risk-weights in tables (9, 10, 11 and 12), the loan must meet the following requirements: Finished property”

Our preference is for residential properties to be exempted from the criteria of “finished property.

Change proposed:

- “Residential Buildings under construction” should be allowed to apply the risk-weights tables in 9, 10, 11 and 12. The inclusion of uncompleted building is a matter of timing and on completion such properties would be eligible. The risk of project non completion can be mitigated by introducing additional criteria such as detailed policy on developer empanelment, project approval and risk management procedures (e.g.

concentration caps, developer approval criteria). This would be the preferred approach to avoid an extra complication to the capital computation process.

An unintended consequence of the higher risk-weight for residential building under construction is that this would have a negative social economic impact. The higher risk-weight would lead to an increase in mortgage pricing for consumers and discourages purchase of new residential properties under construction.

- The risk-weight in paragraph 54 should be applicable for qualifying residential mortgage loans (and not only to individuals). The restriction to individuals is not justified. Higher risk lending on residential real estate properties is adequately covered in paragraphs 55, 56 and 61.

LTV ratio (Paragraph 52)

“The value of the property will be maintained at the value measured at origination unless national supervisors elect to require banks to revise the property value downwards

Footnote: If the value has been adjusted downwards, a subsequent upwards adjustment can be made but not to a higher value than the value at origination”

The two proposals as below are (1) is to remove the restriction on upward re-valuation and (2) Provide option for banks to use the value at origination for specific markets with limited property market data.

Change proposed:

- In many developed markets with robust market property price indices and data, statistical methods are used by banks to monitor the value of properties. The restriction that upwards adjustment cannot be a higher value than the value at origination overly complicates the monitoring process. We would like to propose that this restriction be removed as the risk can be covered by periodic re-valuation of the properties as mandated by national supervisors.
- In recognition of the fact that international banks operate in many jurisdictions, it is proposed that where banks are unable to comply with national supervisors election for periodic re-valuation of properties in specific markets, they should apply the property value measured at origination for those markets. The use of professional valuers for re-valuation of properties is generally not cost effective and can be prohibitive.

Residential Real Estate Exposures (Paragraph 55)

“Table 10 risk-weights for residential real estate exposures (repayment is materially dependent on cash flows generated by property)

If the requirements of paragraph 50 are not met, at 150%”

Change proposed: The risk-weights are too punitive. The bands should be expanded in the table.

- Table 10 – we would propose that the LTV bands be expanded by 1 lower band at 40% and 1 higher band at 100%. This would encourage more prudent lending at lower LTV bands (< 40%) and discourage imprudent lending (LTV > 100%)
- Table 10 – We would propose a max. 90% risk-weight at the highest LTV band (LTV > 100%) to accord some recognition to the collateral. The proposed max. 120% RW is punitive compared with the counterparty RW for individual (75%) and SME unrated corporate (85%)
- Where the requirements in para 50 are not met, the proposed 150% risk-weight is too punitive compared to the counterparty RW for Other Retail (100%) and SME unrated corporate (85%). This is equivalent to a risk-weight (i.e. 150%) for defaulted unsecured exposures. We would propose a risk-weight of 100% for individuals and 85% for SMEs. This is consistent with the assumption that the exposure is unsecured and not defaulted.

Commercial Real Estate Exposures (Paragraph 58)

“Table 11 risk-weights for commercial real estate exposures”

Change proposed: the risk-weights for commercial real estate should be revised to include more risk-weight bands, allowing for this exposure class to be more accurately captured. The maximum risk-weight should be maintained as this appears reasonable to us.

- Table 11 – we would propose that the LTV bands be expanded by 1 lower band at 40% and 2 higher bands at 80% and >100% (LTV<40%, LTV 40-60%, LTV 60-80%, LTV 80-100% and LTV > 100%). This would encourage more prudent lending at lower LTV bands.

Commercial Real Estate Exposures (Paragraph 59)

“Table 12 risk-weights for commercial real estate exposures (repayment is materially dependent on cash flows generated by property)”

If the requirements of paragraph are not met, at 150% “

The risk-weights are too punitive.

Change proposed: The bands should be expanded in the table.

- Table 12 – we would propose that the LTV bands be expanded by 1 lower band at 40% and 1 higher band at 100%. This would encourage more prudent lending at lower LTV bands (< 40%) and discourage imprudent lending (LTV > 100%)

- Table 12 – We would propose a max. 100% risk-weight at the highest LTV band (LTV > 100%) to accord some recognition to the collateral. The proposed max. 130% RW is punitive with the counterparty RW for individuals (75%) and SME unrated corporate (85%). A lower risk-weight is proposed to support SMEs in the purchase of their own premises.
- Where the requirements in para 50 are not met, the proposed 150% risk-weight is too punitive compared to the counterparty RW for Other Retail (100%) and SME unrated corporate (85%). This is equivalent to a risk-weight (i.e. 150%) for defaulted unsecured exposures. We would propose a risk-weight of 100% for individuals and 85% for SMEs. This is consistent with the assumption that the exposure is unsecured and not defaulted.

Add-on risk-weight to certain exposures with currency mismatch (Paragraph 62)

“For corporate, retail and real estate unhedged exposures where the lending currency differs from the currency of the borrower’s main source of income, banks will apply a add-on of 50% to the risk-weight applicable to paragraphs (31-60), subject to a maximum risk-weight of 150%”

More stringent credit acceptance criteria are applied by banks to manage foreign currency risk, (e.g. via lower LTV and Debt Servicing Ratio). Therefore the proposed add-on seems overly punitive and is seen as a double overlay.

Change proposed:

- Lending to high net worth individuals (classified as corporate exposures) with income streams from multiple currencies would be impacted and from experience this customer segment has very low default rates. This segment should be exempted.
- The max. risk-weight of 150% is punitive. The proposal is to allow a lower add-on (e.g. 10%) where the bank has applied a prudent discount on the foreign currency income in the credit assessment of the borrower’s ability to repay.
- It should be clarified in the STA text that the source of income needs to be verified only once when the loan is granted for retail exposures (including mortgages). For retail facilities (e.g. mortgage loans, credit cards), customers are not required to provide updated income documentation and there is no manual review and renewal process. For example, credit cards are normally auto renewed based on behaviour scores.