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

20 June 2016

RESPONSE TO THE CONSULTATION ON REDUCING VARIATION IN CREDIT RISK-WEIGHTED ASSETS – CONSTRAINTS ON THE USE OF INTERNAL MODEL APPROACHES

Dear Mr. Coen

We understand 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.

However, we are concerned that the current proposals place too great an emphasis on simplicity and will compromise the incentives mechanism built into the existing framework for regulatory capital to be allocated in a suitably risk-sensitive manner. Thus threatening the work that has gone into the risk based framework established since 2006.

Capital metrics are central not only for demonstrating capital adequacy at the 'top of house' level, but also for a range of downstream applications within the firm: in banks' strategic planning, in how they price deals, in portfolio construction (and the risk of adverse selection), and in how bank staff are assessed and remunerated. Risk-sensitive capital metrics are therefore essential for ensuring appropriate signalling and encouraging desired behaviours.

We note the Committee's continued objective *to not significantly increase overall regulatory capital requirements*; however, we find it difficult to reconcile this aim with all of the recent proposals and guidance which suggest significant and business model changing increases for individual risk types as well as at an aggregate level.

Risk Sensitive Framework

We strongly believe that the overarching objective of *balancing risk sensitivity, simplicity and comparability* can be achieved without the need to significantly restrict internal modelling as proposed in this consultation. If followed through, the proposed revisions would result in a decoupling of internal risk management and regulatory requirements, as was the case prior to the implementation of Basel II.

Consequently, our primary concern with the Committee's proposals is less about models, and more about the bluntness of the approach that the Committee proposes to replace these with. Under the proposed new standardised approach (in the case of banks, financial institutions and corporates) and the current Supervisory Slotting Criteria (for Specialized Lending), all assets are herded into only three or four risk buckets (or less, for unrated corporates), which tend to overstate risk on the best credits but understate it on the weakest. To the extent that the Committee aims to

keep the standardised approach simple and fit for purpose for small banks, it is manifestly inappropriate for large and diversified financial institutions.

We want to clearly express our support for the European Banking Authority's view that the internal model based approaches are still the most effective way to determine capital requirements for those banks that are willing to commit the substantial resources required to adopt and maintain the approach.

As such, rather than discarding the internal model based approaches we suggest implementing and following through on the European Banking Authority's repair programme, which amongst others addresses the underlying modelling processes and their oversight, and to consider the proposals made by the Institute of International Finance's Risk-Weighted Assets Taskforce in its report of November 2014.

Capital Floors

We note that the leverage ratio has been consistently described by the Basel Committee as a "supplementary" or "backstop" measure. At best, a capital floor becomes a second backstop, which seems unduly duplicative. This is then further compounded by the proposal to have both an output capital floor and the series of parameter input floors as well.

We do not believe it is necessary or appropriate to have both an output floor as well as the series of parameter input floors. Such a combination would undermine the Committee's objectives of simplicity and comparability, as well as risk-sensitivity.

Adding an additional floor dimension might give an illusion of comparability but it will not enrich the understanding of stakeholders. Rather, it would distort the meaning of some of the measures, increasing complexity for investors seeking to understand a bank's risk portfolio, and for the banks seeking to allocate capital effectively. This additional layering brings undue complexity and instability to the capital framework.

We acknowledge the need to have a backstop measure to risk-based capital; however, great care should be taken in determining how such a backstop is calibrated, to ensure that banks' key strategic drivers and performance measures are not compromised in their sensitivity to the underlying risk.

Trade Finance Perspective

As a business line for banks, Trade Finance significantly helps to increase portfolio diversification and from a macro-economic point of view contributes to supporting trade flows across the world. Trade Finance products typically are short term and self liquidating in nature.

We are concerned that the Committee's proposals will not allow for sufficient differentiation between obligors, instead grouping risk-weights into a few external categories. Recognition for collateral and tenor will also be limited despite the well documented short term nature of Trade Finance exposures and the fact that very effective collateralisation and risk mitigation options are available.

Increased capital requirements as a consequence of the current proposals will impact the pricing of such products and the availability of Trade Finance (which is the lifeblood of trade) to key sectors in emerging markets.

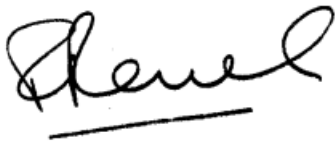
Timelines

We acknowledge the Committee's commitment to the G20 to complete its work by year-end 2016. However, the scope, extent and magnitude of change in the credit risk and overall regulatory capital frameworks warrant careful consideration to ensure the removal of risk sensitivity does not lead to a systemic mispricing of risk and inappropriate allocation of capital across the banking sector.

The proposals represent the most fundamental set of changes to the calculation of risk-weighted assets since Basel II, therefore should be subject to the same level of consultation and analysis; by way of comparison Basel II took 7 years and involved many consultations and 5 quantitative impact studies.

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

Sincerely,

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

Roselyne Renel

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