The Trust Companies Association of Canada

March 26, 2015

Submitted electronically via www.bis.org

Basel Committee on Banking Supervision
Bank for International Settlements

Dear Committee Members;

Re: Consultative Document – Revisions to the Standardised Approach for credit risk

This letter contains the comments from the Trust Companies Association of Canada Inc. (TCA) and its Members on the Basel Committee on Banking Supervision (BCBS) Consultative Document *"Revisions to the Standardised Approach for credit risk"*. We want to thank the Committee for the opportunity to provide comments.

By way of background, the TCA was incorporated under the *Canada Corporations Act* on January 21, 1986 and on August 11, 2014 the TCA was continued under the *Canada Not-for-Profit Corporations Act*. The TCA represents 21 small to mid-sized financial institutions which are regulated by the Office of the Superintendent of Financial Institutions, Canada. The TCA advocates for effective public policies that contribute to a sound financial system, benefitting all Canadians and Canada's economy.

The objectives of the TCA are to foster sound and equitable principles in the conduct of all phases of the financial industry; afford through meetings and otherwise opportunities for consultation and co-operation in matters of interest and importance to TCA members; gather, research and distribute information of interest and value to TCA members; promote the interests and welfare of members and those they serve; represent the interest of the TCA in consultation with governments, consumer groups, other associations and financial institutions and before the public.

The views expressed in this letter take into account comments from member Companies of the TCA and their staff.

In general, the TCA is supportive of the Committee's objective to increase the risk sensitivity of the standardized approach for credit risk and improve comparability across banks, where possible. However, we do not believe that the proposals contained in your consultative document will achieve these objectives as currently designed. The TCA has the following comments on the proposals.

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Overall Capital Requirements
While the BCBS did not have the objective of increasing capital requirements, the proposals as designed would, in most instances, lead to higher capital requirements for non-IRB DTIs in Canada, as discussed below.

Risk Sensitivity
Improving the risk sensitivity of risk-weights is a desirable objective; however, the utilization of the proposed simplified risk drivers may not effectively rank order risk consistently across jurisdictions, business models or individual loan exposures,. In fact, in some cases, the proposals may lead to counter-intuitive results. Under the current proposal many key risk drivers are omitted to meet the objective of simplicity.

The TCA has the following observations related to risk sensitivity;

Exposure to Banks
The proposals would in most cases lead to higher capital requirements for bank exposures and short term deposits in Canada.

The proposed risk drivers of the CET 1 Ratio and NPL Ratios will not appropriately rank order credit risk in the absence of consideration of external ratings (see comment below), government support mechanisms or business models. For example a bank with a CET 1 ratio over 12% and a NPL ratio below 1% would receive the lowest risk-weighting, regardless of its business model, liquidity position or jurisdiction. However, the higher CET 1 ratio may reflect a higher risk business model requiring higher levels of capital while the NPL ratio may reflect the point in the credit cycle and not relative asset quality per se. In Canada, the largest five D-SIB DTIs would receive a higher risk weight than many of the smaller less diversified DTIs, which we do not believe is the intended outcome.

The use of these risk drivers would further contribute to pro-cyclicality and could potentially amplify the effect.

Use of External Credit Ratings
The TCA supports reducing reliance on external credit ratings as an *exclusive* measure of risk-weights as an appropriate objective. However, unlike the simple risk drivers proposed, which are point-in-time measures; external credit ratings include, expert judgment, comprehensive consideration of multiple risk drivers, both quantitative and qualitative, along with forward looking information, all of which pass a rigorous discussion and approval process before being published. Compared to lagging financial risk drivers, external ratings may also provide more timely recognition of changes in credit risk. Financial statement information could be as much as a year delayed and

represents the previous year's impact. In addition, capital ratios and asset quality ratios tend to be lagging indicators of solvency.

The TCA encourages the Committee to consider the use of both external ratings and appropriate risk drivers, when developing risk weightings for exposures to Banks and Corporates.

Exposures to Corporates

In many cases the proposals would lead to higher capital requirements in Canada.

Using only leverage and revenue as risk drivers may not always rank order risk across business models or the varied economic status of jurisdictions and lacks consideration of external credit ratings as discussed above. Additionally, definitions of leverage and revenue would be difficult to define simply for consistent application. There could be difficulty accessing the relevant information in a timely and cost effective manner and the level of accuracy of the information could vary widely. For the revenue measure there would need to be consideration of foreign exchange implications.

Specialised Lending

The proposals would lead to higher capital requirements in Canada and do not reflect the risk drivers that are considered in underwriting these types of loans.

For example, collateral is not considered as a risk driver when in fact, the collateral value of commercial real estate is often an important risk driver in advancing these types of loans; and, as such, the residual risk can be very low. Prudent underwriting practices in Canada has led to very low losses in this category of lending.

Additionally, further clarification is required on the treatment of residential mortgages for rental properties, as the proposal indicates that to be considered a residential real estate exposure the risk of loan repayment must not be materially dependent upon performance of, or income generated by, the property securing the mortgage. Treating residential mortgages for rental properties as Specialised Lending would materially increase the capital required for these mortgages and would not rank order risk based on the proposed flat risk weighting.

Residential Mortgages

The proposals could lead to higher capital requirements and in many cases will not rank order risk effectively because meaningful risk drivers are omitted from the determination of risk-weights.

Loan-to-value (LTV) is often a meaningful risk driver for loss given defaults for residential

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mortgages and in some cases the probability of default, however; LTV combined with just the debt service coverage (DCS) ratio may not rank order risk effectively as these two risk drivers alone do not provide a meaningful differentiation of borrower credit behavior which is statistically relevant to the probability of default. For example, a mortgage to a Prime borrower could receive the same risk-weight as a mortgage to an Alt-A borrower (defined as a borrower with a lower credit score, in this case) when the LTV and DSC ratio are the same for each mortgage despite the higher credit risk associated with the Alt-A borrower. While this is the case today with the current flat 35% risk-weight, the objective of the proposals is to improve the risk sensitivity based on ranking credit risk which it would not achieve in these cases. Additionally, there is no risk differentiation between insured and uninsured mortgages or any consideration for the time left to maturity.

While LTV is generally a relatively straight forward calculation and the definition could, in most cases, be applied consistently, DSC may not be comparable across jurisdictions or even locally, particularly if after tax income is used.

National Discretion

While the TCA understands that reducing national discretion to improve comparability is an important objective, in some cases over-simplification across jurisdictions may fail to recognize the differences in local laws, policies, products and business practices that have meaningful effects on risk. National supervisors are best placed to understand these differences and instead should be subject to reviews and challenge on adoption of Basel principles by international peer groups and the International Monetary Authority, when appropriate. For example, there are meaningful differences in residential mortgage conditions and product offerings between the United States and Canada that have meaningful effects on the inherent risk of these loans.

Thank you for the opportunity to share our perspective on this consultative document. If you have any questions or wish to discuss our comments please contact Chris Ahlvik, Secretary of the Trust Companies Association, 145 King St. W., Suite 2300, Toronto, Ontario, Canada M5H 1J8; direct phone number: 416 775 5005; email address: chris.ahlvik@hometrust.ca.

Sincerely,
The Trust Companies Association of Canada Inc.

Gerald M. Soloway
Chair

c.c. The Office of the Superintendent of Financial Institutions, Canada