



CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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

Re: Consultative Document, Reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches

Dear Sir or Madam:

The U.S. Chamber of Commerce (the “Chamber”) created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.¹ The CCMC appreciates the opportunity to comment on the Basel Committee on Banking Supervision’s (the “Basel Committee”) consultation on reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches (the “Consultation”).

The Chamber has commented extensively with the Basel Committee and U.S. banking regulators on the impact of capital, liquidity and leverage standards upon the ability of non-financial businesses to raise the resources needed to grow and operate.² Our comment letters have focused on the need for a comprehensive economic

¹ The Chamber is the world’s largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector.

² See June 14, 2011 letter from the Chamber to Federal Reserve Chairman Ben Bernanke on G-SIFI surcharges, October 22, 2012 comment letter to U.S. banking regulators on proposed Basel III regulations, September 19, 2013 letter to the BCBS on the Revised Basel III leverage ratio framework, September 23, 2013 letter to U.S. banking regulators on enhanced supplementary leverage ratio standards, January 31, 2014 letter to U.S. banking regulators on liquidity coverage ratio rules, January 31, 2014 coalition letter to U.S. banking regulators on liquidity coverage ratio rules, May 28, 2014 letter to NCUA on risk based capital, September 11, 2014 letter to Federal Reserve on Capital Plan and Stress test rules, September 19, 2014 letter to Bank of International Settlements on The Net Stable Funding Ratio, letter of February 11, 2016 on Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, letter of March 21, 2016 to Federal Reserve on Framework for Countercyclical Capital Buffer, and letter of June 3, 2016 to Federal Reserve on Single-Counterparty Credit Limits for Large Banking Organizations.

analysis of the impact of these standards on nonfinancial businesses that depend on access to finance in order to drive growth, mitigate day-to-day business risk, and manage liquidity.

Despite these comments, however, the Chamber has found a continued lack of concern for the cumulative impact of such standards on nonfinancial companies, as well as whether new standards impact the availability and cost of products and services most crucial to drive economic growth. The Consultation adopts the same erroneous approach by removing the critical importance of risk-sensitivity in evaluating the potential and probability of a borrower's default in favor of a standardized approach.

In sum, requiring the use of the standardized approach would discard the use of risk-sensitive models in favor of an approach that cannot differentiate risk among borrowers that share certain profiles. This is particularly troubling for the corporate community, as the Consultation lumps together all corporates with over €50 billion into one category. By using such a blunt tool to address potential variation in internal models used by banks, we fear that lending to traditional, low-risk borrowers (particularly investment-grade corporations) will be subject to substantially higher capital charges, which may either shrink access to credit for these borrowers or cause the costs to be passed on to them.

Our concerns are elaborated in greater detail below. In addition to considering these comments, we would also draw your attention to our recently released report: [*Financing Growth: The Impact of Financial Regulation*](#). The report is based off of a survey of more than 300 corporate finance professionals, including CFOs and treasurers, and examined the impact of financial services regulatory reform on the availability and cost of the products and services most crucial to the growth of Main Street businesses. Key findings from the report include:

- More than three-quarters of American companies of all sizes believe that the cumulative effect of financial regulations adopted over the past six years is making it harder for them to access the financial services they need;

- 86% of companies surveyed indicated that it is important for financial services providers to provide a wide spectrum of services;
- 57% of all companies surveyed use at least eight critical bank services, including cash management, obtaining short-term and long-term loans, utilizing derivatives for risk management, and issuing commercial paper;
- 65% want financial services providers to specialize in specific products;
- 79% indicate that they are affected by changes in financial services regulation;
- As a result of these changes, 39% of respondents have absorbed higher costs, and 19% have delayed or cancelled planned investments;
- 76% believe that the regulations on the financial services sector will not help their companies' outlook over the next two to three years.

We believe that a full consideration of these conclusions should guide the Basel Committee in its finalization of any steps taken to reduce variation in credit risk-weighted assets through the internal model approach.

Discussion

While there are several parts of the Consultation that are concerning,³ our comments are primarily focused on the treatment of corporate exposures under the Consultation. As a general matter, we believe that any change to the internal ratings-based (“IRB”) approach should be considered in conjunction with recent capital and liquidity reforms that impact lending to the corporate community. For example, required bank capital has more than doubled since the financial crisis, with Basel III minimum bank capital requirements rising from 8 percent to up to 15.5 percent of

³ For example, we are concerned about the Consultation’s treatment of exposures to banks and securities firms, as well as corporate exposures to financial institutions not treated as banks, as well as exposures to small-and-medium enterprises not treated as retail. The consultation generally shifts these categories from an internal ratings based approach to the standardized approach.

risk-weighted assets when all surcharges are included.⁴ This figure, however, does not include the amount of capital required under reforms such as total loss-absorbency capacity debt requirements, the limitations on the types of assets that can be held by a bank under the liquidity coverage ratio or net stable funding ratio, or the limits on exposure a financial institution may have to one borrower under the relevant single counterparty rules.

Consequently, we strongly urge the Basel Committee to maintain the risk-sensitivity of its current capital framework in order to mitigate the cumulative impact of other bank capital and liquidity reforms. However, as proposed, the Consultation's shift from an IRB approach to the standardized approach for all corporate exposures where a corporate borrower has more than €50 billion in assets will necessarily require impacted financial institutions to be more conservative in lending to these businesses. As a result, a large portion of the corporate community that has come to depend on access to finance for short-term needs and long-term growth will all be treated similarly under the standardized approach, potentially increasing the cost of accessing credit.

We find this particularly troubling because the Basel Committee's rationale for this change is premised on the belief there is insufficient information to model the impact of a default. By making this change, the Basel Committee seems to ignore the wealth of information that financial institutions gather during the credit intake process and the precision used by a banking institution to develop an internal model that is reflective of potential portfolio risk.

These consequences make it extremely short-sighted to eliminate the IRB approach altogether. Instead, we recommend that the Basel Committee take steps to improve the collection of information in order to address any potential variance based on the IRB approach. In this respect, we welcome proposals such as that developed by the Institute of International Finance ("IIF") to adopt common benchmarks for

⁴ See Pg. 5, J. Daghar, G. Dell'Ariccia, L. Laeven, L. Ratnovski, and H. Tong, IMF Staff Discussion Note, *Benefits and Costs of Bank Capital* (Mar. 2016), available at <https://www.imf.org/external/pubs/ft/sdn/2016/sdn1604.pdf>.

sufficient data for modeling, as well as choosing a risk-based evaluation of unrated subsidiaries over the standardized approach.⁵

Moreover, we believe that inappropriate pricing of risk through the standardized approach will directly hurt lending by banks at a time when jurisdictions around the world are working to bolster access to credit from banks. For example, the European Union has actively sought to improve access to finance through the announcement of a Capital Markets Union (“CMU”). One important aspect of the CMU is improving data quality for smaller borrowers, providing financial institutions with the requisite information to support a lending decision. We believe that it is contradictory for policymakers to support lending through enhancements to the credit intake process on the one hand, while limiting those very same tools with respect to lending to other, larger institutions.

Finally, we believe that the Consultation – as well as other recently proposed reforms, such as the Fundamental Review of the Trading Book and the changes to the standardized measurement approach for operational risk – represent more than cosmetic, technical changes to improve consistency in capital regulations. Instead, the Chamber strongly believes that these reforms, taken together, constitute a substantial restriction on the ability of banks to support lending to the nonfinancial community and support key areas of the capital markets upon which the global economy relies, such as the commercial mortgage-backed securities market. This suite of changes – which many refer to as Basel IV – should not be implemented without a comprehensive study of how these various regulatory initiatives interact with preexisting capital and liquidity requirements, followed by a study on the impact of these initiatives on the broader global economy and the capital formation system that is the linchpin for growth.

In sum, removing bank discretion in lending to the corporate community, without considering alternative approaches, is a misguided attempt to address unwarranted variance in IRB approaches. The Chamber strongly believes that permitting banks to use the IRB approach better supports access to finance for the corporate community and permits lenders to closely evaluate the potential risk of

⁵ See Pgs. 25-33, Response of Institute of International Finance, Consultative Document, Reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches (Jun. 3, 2016), *available at* https://www.iif.com/file/16000/download?token=tmKVk_Lv.

borrowers in a far more risk-sensitive manner than the standardized approach. Consequently, the Basel Committee should remove the recommendation to apply the standardized approach for corporates in any final action taken to address variance with IRB approaches.

Conclusion

The Chamber appreciates the need for the Basel Committee to address variances in IRB models in order to promote consistency in the evaluation of credit risk across different lenders. However, the approach chosen by the Basel Committee has the serious and foreseeable consequence of increasing the cost of credit for many investment-grade corporate borrowers. Rather than entirely discarding a risk-sensitive approach that is centered on the individual risk posed by a borrower, we believe that the Basel Committee should take steps to improve the IRB approach as necessary. This is all the more necessary in light of the cumulative impact of bank capital and liquidity regulations that have already begun to damage access to credit by corporate borrowers of all sizes, as highlighted in our report.

We thank you for your consideration of these comments and would be happy to discuss these issues further with you or your staff.

Sincerely,

A handwritten signature in black ink, appearing to be 'TK' followed by a long, sweeping horizontal stroke.

Tom Quaadman