European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

EACB Comments on the Consultative Document of the Basel Committee on Banking Supervision

Revisions to the Standardised Approach for credit risk

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General Remarks

The members of the EACB welcome the opportunity to comment on the BCBS review of the standardised approach (SA) for credit risk.

In principle, we appreciate the overarching idea of maintaining the SA as simple as possible to allow effective implementation. However, the proposed review reveals a number of decisive criticalities that need to be addressed to avoid unintended and disproportionate negative impacts on credit institution, both those adopting the SA and those adopting IRB models.

In general, any change in the SA framework should be clearly limited to those areas where it has become clear, after a thorough assessment, that the SA framework underestimates risk.

We therefore highly appreciate the statement that the objective is not to increase overall capital requirements, however the values of the parameters and factors proposed decisively point in the direction of a significant capital increase. Moreover, other consultation processes strictly related the SA review have been carried out (e.g. Counterparty Credit Risk for OTC derivatives) or are still underway (e.g. Fundamental Review of the Trading Book) which could also result in an increase of the overall capital requirements.

The review should allow sufficient time for a meaningful calibration that is not based on a one-off QIS exercise, for which the submission of data not readily available could be difficult and/or partial. In addition, also the phasing in of such an extensive and far reaching proposal, in terms of impacts and implication, should be adequately planned, in order to avoid undue and unintended destabilisation of the financial system.

Increased risk sensitivity can produce an improvement if the risks are accurately measured. Therefore, for a SA revision on the model of the one proposed to be successful, it would require not only a global framework in which the best performing risk drivers (based on empirical evidence) are selected, but also a calibration of risk weights per jurisdiction, within a clear set of calibration rules. Supervisors should have sufficient room to better reflect specificities of the local markets that can hardly be adequately encompassed at the global level, in particular in areas such as the corporate, retail and real estate portfolios. Supervisors and the banking industry should co-operate in ensuring that the empirical evidence underpinning the proposed risk weights is actually representative and sufficiently deep.

Some element of the proposed review go in the direction of increased procyclicality, as a worsening of the economic scenario would have a detrimental impact on the risk drivers to a greater extent than currently envisaged. This would be true for both the SA and the IRB, via the introduction of floors. The use of CET1 ratio could trigger important fluctuations in capital requirements due to its relation to risk-weighted assets. Moreover, the derivation of risk weights from simply two drivers will also increase the volatility of

the asset portfolio. This may eventually have unintended consequences also to respond adequately to the planning of supervisory activities and poses the risk of inducing a permanent destabilization of the financial system in terms of capital adequacy.

Finally, the proposed review should be seen in context also with the proposal for the introduction of capital floors based on SAs for IRB models. If such floors were to be eventually introduced, the calibration of the SA would require an even greater effort in order to avoid inducing a reduction of the risk sensitivity of IRB models, and constraining the crucial importance that IRB models have for the management of institutions. The introduction of standardized (simple) approaches in combination with capital floors may lead to a behaviour of taking relatively higher risks with same – because floored – RWAs and with higher remuneration thus making banks riskier, although with higher capital positions ('Basel I arbitrage problem').

The SA – exclusive method of capital calculation for small banks

While the Committee generally designs, in principle, the rules of the SA for internationally active banks, this standard will be relevant, if not even the global benchmark also for the smallest banks. In fact, in many jurisdictions (e.g. EU) the rules will be directly applied to all institutions as a one-size-fits-all approach. The standardized approach is the exclusive calculation method for the calculation of capital requirements for smaller banks. Therefore it should be simple and easy to handle in the first place.

We have doubts that the proposal fits these requirements: the evaluation and monitoring of the different risk drivers, very often on a permanent basis, the generation, collection and administration of numerous data and the increased complexity of calculation method will in fact imply a serious challenge for smaller institutions. We seriously wonder, how institutions in less developed countries will be able to comply. But even smaller cooperative banks in the EU may simply be overburdened.

Increasing risk sensitivity

While the general idea of increasing the risk sensitivity of the standardized approach seems to be a tempting idea at first sight, the proposals for achieving such risk sensitivity appear to be far less seducing: two risk-drivers per category seem to allow only a very limited power of expression and differentiation (with "revenue" under corporates being probably the least "expressive" one.): in fact such two-dimensional approach will in many cases deliver inappropriate results, so that we are not fully convinced that it would really be superior to a more schematic approach (which would at least be better to administer). We therefore wonder whether it would not be useful, in the case of smaller banks, to rather keep a more schematic approach and rather focus within supervisory processes on appropriate methods of risk assessment and monitoring by banks.

For many exposures, such as trade and commodity finance, project finance, SME lending, etc. it is the combination of the structure and or risk mitigants that considerably lowers the overall risk profiles. Taking into account these mitigating effects is thus essential. Not doing so could lead a healthy business model to turn into a non viable business from a capital allocation perspective. Moreover, banks with IRB portfolios can share a lot of valuable data to back up these mitigating effects, that should be translated into lower risk weights

As regards the role of the standardized approach as a benchmark for any floor calculations, we consider it doubtful that a parameter generated on the basis of two risk-drivers (only) would provide a floor for IRB approaches that achieve a much higher risk sensitivity by taking more aspects into consideration.

External ratings

For the same reasons we ask the Committee to reconsider its point of view regarding external ratings. Even during the crisis, the ratings of banks and corporates remained reliable and since then many improvements were introduced. It seems odd to determine capital requirements for exposure to banks from the perspective of a very simplistic two-dimensional approach, while ratings from external agencies deliver a much more detailed and precise picture. The reduction of the reliance on external ratings would rather end in a much less risk-sensitive approach at all. We therefore believe that the use of external ratings of banks and corporates should remain, along with the option of using the sovereign method for unrated banks, which as an alternative should at least have more appropriate risk drivers and calibrations with better definition and testing than the ones proposed. We would like to recall as well that the new Basel securitization framework still uses external ratings, as does the new market risk framework being proposed under the Fundamental Review of the Trading Book (FRTB), we believe that this further evidences that complete removal of external ratings is both unnecessary and undesirable.

Data requirements

Moreover, the proposals require banks to collect, introduce into the system and document many data from their customers. The amount of work and time required for such collection and analysis should not be underestimated:

In many jurisdictions it is not mandatory for all undertakings to prepare annual accounts. Obtaining such information from a customer may also be relatively easy at the time when a loan is requested, but become much more difficult over the years.

Moreover, it should also be accepted that retail customers and mortgage lenders may be anything but keen to deliver data to banks. We would generally expect reluctance of customers to provide data about their income, their personal situation, etc. on a regular basis. We would also expect that customers would get some support from data protection agencies in this respect.

In some areas, e.g. corporates, the collection of data may even be completely out of proportion to the importance of the exposure: it may be totally disproportionate to be obliged to collect detailed data of a large corporate in the context of a very minor exposure (e.g. some minor overdraft facilities of a large corporate). We therefore suggest to introduce some de-minimis rules for minor exposures, which would allow to avoid the collection of data in the case of "mini-exposures", or a certain impureness rate.

Without electronic data transfer, the introduction of customer data in the systems of banks may become extremely time-consuming, especially if it were required to introduce the data of existing customers.

Furthermore, a treatment based on the concept of "investment grade" (as specified at page 22 of the CP) could be envisaged for the cases where an obligor has not provided its relevant data, instead of the most penalizing treatment (e.g. in the case of senior corporate exposures, 110% RW instead of 300% RW).

In addition, frequency of update of required data should be determined appropriately without undue burden in light of the cost associated with data collection.

Higher capital requirements

We also suspect that revision will in fact lead to substantially increased capital requirements. While the paper states (pag. 2) "*Increasing overall capital requirements under the standardised approach for credit risk is not an objective of the Committee*" the risk weights for some exposures would be considerably increased (e.g. the lowest risk weight for bank exposures would increase from 20% to 30%, while that for corporate exposures would increase from 20% to 60%). Moreover, it seems that the proposed revisions would mainly penalize banks with high quality portfolios (capital increase for high quality mortgage portfolios and increases for the minimum weights of banks and corporates). This could potentially result in wrong incentives for banks using the SA for credit risk and, given the intended capital floors, also the high quality IRB portfolios will be hit disproportionately.

In this regard, the overall calibration of certain requirements (e.g. corporates), may be much more burdensome for smaller banks, as the financing of smaller business may cover a higher proportion of their portfolios, and the joint effect of some measures (corporates, retail) may even amplify restrictions on financing.

In fact, the calibration of certain elements implies general policy choices that go beyond risk management indications, in particular:

- A potential degradation of access to finance for SMEs, vs. a preferred treatment for large corporates;
- A pressure towards consolidation to achieve greater size of banks (e.g. the hardened granularity criteria for retail exposures).

In addition, we see a lack of level playing field. Other financial service providers could have an enormous advantage by not having these high capital requirements which are

applicable for banks. The expected increase in capital requirements could favour peer to peer lenders and other unregulated models. We have doubts that this would be the outcome intended by the Committee.

Accounting Standards

The calculation of the different risk drivers, like leverage, may provide differing results due to differences in accounting standards. In particular, there may be relevant differences regarding the "capital" of an undertaking.

1. Exposures to banks

Definition of bank exposures

The definition for bank exposures provided under Annex I, para. 12 seems to narrow. It would leave a number of institutions out of the scope of this category of exposures, thus including them among the corporates. In particular, it is not clear from para. 12 whether smaller domestic banks, in jurisdictions unlike the EU where the full Basel standards do not apply to them, fall within the definition of bank at all. This would clearly contradict an accurate risk representation and an increased risk sensitivity. We therefore believe that all supervised financial institutions should get comparable risk weights.

We also suggest specific risk weights should be introduced for other regulated financial entities, like insurance companies. They would otherwise have to be treated as "corporates", while the suggested risk drivers for corporates, including their calibration seem to be inappropriate for such entities.

Risk Drivers

We appreciate the fact that the Committee is seeking to maintain a simple approach by envisaging a limited number of risk drivers. However, as mentioned earlier, reducing the assessment of risk of bank exposures to just two risk drivers does not seem in line with current risk management practices and may not offer any real advantage versus the use of external ratings.

In particular, we do not see the rationale behind the selection of the two risk drivers in question. We would like to underline again that the process leading to the assigning of an external rating draws on a much larger set of indicators and provides a much more complete picture. The reliance on external rating for this class of exposures should be preserved. Rating agencies are studying a large number of parameters to adequately assess risks and are in continuing relationships with the banks. Moreover, it is not on banking exposures that external ratings have shown inadequacies in the past.

The approach designed for bank exposures also seems inconsistent with the new international regulations developed in recent years that focus on the constant monitoring of risk profiles and foresee actions on liquidity aspects, resolution, leverage, stress impacts.

We also do not see why the lowest risk weight in banking has been raised to 30%.

Problems may arise from a rule insisting that the breach of any minimum prudential requirement imposed by supervisor (e.g. SREP) would trigger a 300% RW. The question is whether such a treatment would be really justified if a bank showed an LCR of 99% or if a bank failed to reach a Pillar 2 SREP ratio set at 20% own funds. Nor is it clear how third parties will ascertain that any such breach has occurred, as the information will not necessarily be public. Moreover, such rule, which could from one moment to the other lead to an increase of the relevant capital requirements by a multiple, may trigger dangerous chain reactions: e.g. in case of a liquidity shock during which some banks would not fully meet the LCR requirements, the resulting 300% risk weight could amplify the crisis, and trigger a negative spiral.

It also has to be taken into account that the use of the proposed indicators on a yearly basis could trigger a concrete risk of pro-cyclicality that would bring no benefit in risk appreciation. The chain effects on funding costs should be properly considered in final calibration.

Maintain current option 1

Moreover, we regret that the Committee does not maintain the current first option for the treatment of banks (para. 60 of the current framework), according to which "all banks incorporated in a given country will be assigned a risk weight one category less favourable than that assigned to claims on the sovereign of that country". Sovereign risk shall be addressed when its review is carried out. We therefore suggest to maintain this approach as an option and to deduct the rating of the banks from the sovereign rating.

Finally, discretion should be granted to the National Authority for the treatment of some national specificities, like cooperative characteristics: where local member banks are obliged to hold deposits in a central institution and do not engage in risky trading and investments as Central institution manage the entire intra-group liquidity, lower risk weights should be applied. The recognition of these elements is particularly important especially when local banks of cooperative groups/networks have a legal obligation to maintain funding at the level of their central institution.

These discretions could be substantiated for instance as the recognition of a 0% RW for intragroup or intra-IPS exposures as currently provided for in the EU. The BCBS seemed already aware of such specificities to a certain extent, as some aspects have been recognised in the LCR framework granting a 25% preferential outflow rate for stable deposits in cooperative groups/networks.

Q.1 What are respondents' views on the selection of the capital adequacy ratio? In particular, is the CET1 ratio superior to the Tier 1 ratio or the Leverage ratio? Do respondents agree that it is necessary to require calculations in accordance with Basel III in order to ensure a consistent implementation?

We generally believe that a CET1 capital ratio is a very strong indicator. Nevertheless, we are concerned that the Committee only focuses on the CET1 ratio. Only focusing on the CET1 seems to contradict the current framework, which also considers AT1 and T2 as relevant and acknowledged capital elements. Completely ignoring these capital elements leads to an unequal treatment and reduces risk sensitivity. At the same time it should be taken into account that different institutions have different means to raise capital, and AT1 and T2 elements may not be relevant for smaller banks. Thus more differentiation is needed and neutrality of the proposal for all banks' business models, sizes and complexity should be ensured, allowing effective comparability. Further fine tuning and research on the risk drivers for bank exposures is certainly needed, also in light of what indicated by the Committee (pag. 7 of the consultation paper) that counterintuitive

results may unintendedly derive when lower risk weights are assigned to institutions, due to obligations to hold higher capital requirements for Pillar 2 measures or due to their systemic nature.

We do not believe that a leverage ratio would be an appropriate factor in this context. The leverage ratio is designed as a backstop. It lacks any risk sensitivity. Introducing more risk sensitivity in the standardized approach for bank exposures by using the leverage ratio as a risk driver therefore does not seem to be a very consistent or sensible approach. Moreover, the leverage ratio would not be neutral for business models such as the cooperative banking groups and networks, for which the numerous intranetwork/intragroup operations, if not adequately recognised, may lead to a distorted and inaccurate depiction of risk.

Q.2 Do respondents believe the net NPA ratio is an effective measure for distinguishing a bank exposure's credit risk? What alternative asset quality measure, if any, should be considered by the Committee?

We believe that the NPA ratio could be an effective measure in principle.

However, from a methodological perspective the proposal poses certain difficulties, particularly to maintain consistency among banks: for example the criteria for recognition of impaired assets may differ country by country due to differences in supervisory approach and accounting.

Another weakness seems to be that the current design of the NPA ratio does not consider the extent to which loans and leases are collateralised. In a given situation such collateralisation may have similar a effect as a provision and lead to a considerably lower LGDs. For some cooperative banks (agriculture) collateralised loans play an important role and is a business they know to handle very well. This should be reflected in the NPA, e.g. by allowing adjustment when LGDs are below average.

Moreover, the importance of the net NPA ratio is related to the level of the interest rates in a given economy and in this respect there are important differences across markets and jurisdictions. For example a NPA ratio of 4% may constitute no big problem in markets where interest rates for loans are above 10% (and depending on that interest margins are above 6%), whereas in markets with interest rates for loans below 3% a NPA ratio of 4% would be quite alarming. For a given level of NPAs changes in the interest rates may have decisive impacts on the sustainability of such positions.

Finally, not including the asset quality of trading book in the NPA ratio is not consistent with the aim to have a measure that would be neutral to banks' business models.

Q.3 Do respondents have views on the proposed treatment for short-term interbank claims?

A stronger differentiation is needed between short term and long term exposures. The treatment proposed for short-term claims is in fact not adequate, only if they have an original maturity date of ≤ 3 months they may receive a 20% points lower RW than the one determined in accordance with the proposed risk drivers, but subject in any case to a risk weight floor of 30%.

Instead, a separation of the risk weight table between short term and long term exposure could be envisaged, drawing the line between the two classes on a 1 year maturity to increase the sensitivity of the proposal.

We see that the proposed RW table is based on the assumption of a 45% LGD and maturity of 2.5 years, which appears far too long. Due to this, the proposed single risk weight table may not reflect the riskiness of a short term bank exposure in an appropriate manner.

As a further element in this regard, it should be noted that institutions are allowed, under para. 322 of the Basel II framework, to calculate internally the risk weights for bank exposures with maturity below 1 year without being subject to a floor.

Based on the data elaborated by one of our Members, the risk weights stemming from their F-IRB approach provide the following results: 7.1% for 3 months maturity, 7.4% for 6 months, and 7.8% for 1 year. It is evident how the proposed floor for short term exposures risk weights of 30% is significantly higher, and hardly justifiably so, than what the data and experience of institutions show.

In addition, we believe that the risk weights for short term bank claims should be based on the remaining maturity of the exposures, to provide a more accurate reflection of risk, instead of the original maturity.

Q.4 Do respondents have suggestions on how to address these concerns on the treatment of exposures to banks? In particular, do respondents have views on how to treat exposures to banks not subject to Basel III in a consistent and risk-sensitive manner?

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2. Exposures to corporates

Risk Drivers

We generally have doubts regarding the selected risk drivers. In particular, the "revenue" criterion seems inappropriate, since it attributes too much important to size (see Q.5).

Overall, it seems that the proposed treatment would entail important potential disadvantages for SMEs and banks with large SMEs' portfolios which would not be justified by the loss experience of last decades and is difficult to justify from a political perspective.

In fact, this is even more relevant in jurisdictions such as the EU, where SMEs are the economy's backbone (99% of businesses, 66% jobs[1]), and where such proposals may be difficult to be properly communicated as they have relevant policy implication ("big is beautiful").

Bank-related products are still the most relevant sources of finance for euro area SMEs, and cooperative banks have been a steady anchor of financing for the real economy also during the most critical moment of the financial crisis. According to data from the ECB, 61% of SMEs considered bank loans as a relevant source of financing, and 53% included bank overdrafts (ECB 2014). In this context also the importance of banking relationships for SME lending must be highlighted: very often enterprises traditionally rely on close relationship even with just one local bank able to lend even when business conditions are difficult.

Therefore, the proposal raises concerns for the likely disproportionate negative impact on own funds of credit institutions, such as cooperative banks, with a tradition of and a focus on SME lending. As indicated by EACB Members, in some jurisdictions institutions with a longstanding practice of SME lending show a portfolio composed at 70% of companies with revenues lower than € 25mn (i.e. in Germany) or even € 5mn (i.e. in Austria). These proportions may even increase due to the granularity criterion proposed for retail exposures. Indeed numerous exposures, especially for smaller institutions which have small aggregated retail portfolios, would migrate from the retail to the corporate category with serious cliff-effect consequences. Consideration could be given to capturing SMEs exposures in a dedicated and appropriately calibrated subcategory.

Technical choices should not lead to unintended but fundamental policy impacts, as raising capital pressure on the activities of cooperative banks with strong ties with the territory by making lending more expensive could also have negative impacts in terms of economic growth and stability.

Moreover, to actually provide a more precise risk assessment, risk drivers should be differentiated by macro-economic sector/type of business (industrial production, multi-year production, retailers).

In addition, we would like to highlight the need to reconsider the cases where the deposit of annual financial statements is not mandatory for the borrowing corporate, while breaches of this obligation by companies would turn into a very penalizing capital allocation for credit institutions (i.e. 300% RW). Also, in the vast majority of cases the financial statements are unaudited and activities of "*appropriate verification and due diligence*" of data (pag. 11 consultation paper) cannot be demanded to internal processes of banks without posing an unbearable burden, in complete misalignment with the purpose of the standardised approach. Finally, also the readiness in the availability of information (depositing times in the Commercial Register and subsequent capture by information providers) poses a relevant issue to be taken into account.

While the credit risk SA since Basel I has not recognized physical collateral (except real estate) for regulatory capital purposes due to the emphasis on simplicity, the new credit

[1] European Commission (2014)

risk SA proposals aims to reflect a reasonable extent of riskiness of exposures (objective ii under Section 1.1) and increase comparability of capital requirements under SA and IRB (objective iii). The proposed review for credit risk SA could achieve both objectives without resulting in undue complexity by recognizing credit risk mitigation to corporate exposures secured by non-financial collateral types that do not qualify as specialized lending (e.g. transportation, industrial, or office equipment that are secondary to the servicing of the loan) and yet substantially increase prospects of recovery in case of default.

Preliminary data assessment on corporate exposures and QIS

We also have doubts on the preliminary assessment underpinning the proposal that SME exposures are generally riskier than exposures to large corporates. In fact, there are at least two elements to be taken into account: first, the data collected may not be relevant across all jurisdictions, and second the preliminary exercise does not seem to take into account the experience of other institutions, acting locally and with better experience and knowledge on SME loans. Furthermore, under the IRB approach, SMEs get a benefit on a single counterparty basis compared to large corporates, to take into account the diversification effect. A similar approach would be expected for the SA. Also, the argument expressed under point 1 at page 11 of the consultation paper, seem more to reflect the aggregated credit quality of the portfolio observed rather specifying the inherent expected riskiness of SMEs vs large corporates.

The proposed matrix of risk weights seems also to overlook the fact that the relationship between default rates and size of a corporate is strongly country specific, and as such it cannot be specified as a global rule (as an example we can quote the case of Italy where businesses with revenues between € 5 and 50mn show a default rate behaviour similar to larger corporates, which does not justify the high risk weights assigned).

Thus, a more thorough calibration of this category should be supported by additional and deeper data collection. In this regard, the scope and timeline of the QIS do not seem to allow sufficient time for a meaningful data collection. In particular, a large proportion of the data that is required by the QIS is either not available in institutions' systems, or is not readily available for aggregation and reporting purposes. Indeed, much of the data requested by the proposed approach does not form part of institutions' capital processes.

The EBA third interim report on the consistency of risk weighted assets (2013) suggested that for SMEs there would be no clear linkage between the variation in the capital requirements and the exposure size. In fact, the enterprises' size (turnover/total assets) seemed to induce lower levels of PDs but also higher levels of LGDs. In addition, it indicated that SME Retail and corporate exposures under the SA represent large parts of banks' exposures in this category in EU (20% of the EBA sample). Thus, collecting significant input from SA institutions may be crucial to calibrate this category.

Q.5 Do respondents have views on the selection of risk drivers and their definition, in particular as regards leverage and the incorporation of off-balance sheet exposures

within the ratio? Would other risk drivers better reflect the credit risk of corporate exposures?

Q6. Do respondents have views on the appropriateness of the proposed treatment, especially with regard to SMEs? And about the more lenient treatment for start-up companies?

Q7. Do respondents think that the risk sensitivity of the proposal can be further increased without introducing excessive complexity?

We appreciate the fact that the Committee is seeking a new perspective while trying to maintain a simple approach, however the proposed review entails numerous element of concern.

In the first place, and as already pointed out for the banking exposures, relying only on two risk drivers, independently from their selection, seems doubtful in risk analysis, at the same time the use of further risk drivers would greatly increase complexity.

In this regard, we do not see clear benefits deriving from a complete discharge of the external ratings-based approach, which showed good predictive power for corporates. On the other hand, we recognise that there could be a substantial unrated part of corporate exposures. Thus, complementing the external ratings-based approach with some alternatives for the unrated corporates could be a more effective solution.

With regard to the choice of risk drivers, we believe that those identified for corporate exposures (i.e. revenue and leverage) may be not significant for identifying cross sectoral risk weights and may even discourage lending to SMEs, as the assumptions on the drivers may not reflect the actual situation of specific and different industries.

It seems that the proposed risk drivers may induce procyclicality, also considering that the proposed buckets and the level of the RWs may give way to significant cliff effects for corporates at border between buckets: the diversification effects of SMEs portfolios should instead be taken into account. SMEs in comparable financial circumstances of large corporates have the same default rates, there would be no economic justification for applying such a different and unfavourable treatment to SMEs.

Numerous other factors play a key role in the risk assessment and could be considered, for instance qualitative drivers such as the industry, the quality of management, etc.

Finally, while we see a merit in providing a dedicated treatment to start ups, the 110% risk weight seems inappropriately high. In addition, it is unlikely that a start-up could achieve within one year a satisfactory level of leverage or profitability. A preferential treatment with a lower risk weight is justified for such companies and should be applied to all start ups, including non-incorporated companies.

The use of "Revenues" as a risk driver

We have serious doubts about "revenue" as a risk driver: We do not believe that the size of the company, as a purely quantitative criterion, should have such a weight. An internal

calculation of one of our members has made evident that the separation power of "revenue" in addition to leverage is rather low.

In particular, the use of "revenues" as a risk driver will disadvantage SMEs even if sound and profitable, and also SMEs deploying a successful business model that does not seek scale merits but specializes in small niche markets. Moreover, the implementation of the bucketing envisaged by the Committee does not seem to be practical if compared with common SME definitions that use a € 50mn revenue threshold as maximum cut-off to qualify for this category, and taking into account that most of the SME portfolio is well below such threshold.

Thus, there is a clear need for identifying alternatives for SME's and risk drivers in line with the characteristics of SME exposures and with a vast data collection from credit institutions.

The use of leverage as a risk driver

Also the use of leverage as a risk driver is a problematic choice, in fact also this element is highly business specific driver (e.g. trade vs. production) and it may also depend on jurisdictional considerations (i.e. legal framework regarding tax shielding and collateral repossession, close out and bankruptcy costs, etc.).

In particular, we believe that leverage (and revenues as well) is completely inappropriate for the case of corporates that are supervised entities (e.g. insurance companies).

For instance, certain EACB members indicated that according to their customer base very small corporates (e.g. with revenues ≤ € 500k) have very low levels of own funds (8% in one specific case) and overall, the vast majority of corporate exposures (70%) have revenues below € 25mn. We can say that for those the own fund ratio is approximately 20%. The new requirements would thus have disproportionate impact on institutions with exposures to such customers. We should be aware that this may have a discriminating effect on these corporates that may thus have a more difficult access to finance.

In addition, the level of leverage does not necessarily reflect the risk of a company. Most exposures to smaller corporates are highly collateralized relative to exposures to large corporates and risk mitigating factors (e.g. guarantees and other collateral) should be better reflected. Relying on "revenues" poses clear problems in channelling financing to start-ups (constraining innovation and economic growth). In this context it is evident how such a definition of RWs for corporate exposures implies general policy decisions which should instead avoid any negative unintended consequence on financial stability and real economy.

Leverage is also problematic when dealing with partnerships or non-incorporated companies. In such companies there is only a fiscal/virtual separation of the company and the patrimony of the owner. The owner's patrimony remains available as collateral for the bank, even though it may not appear on the balance sheet of the company. Thus in these partnerships and unincorporated companies, differently from companies with legal personality, the liability of the entrepreneur is not limited to the own funds actually

poured in the company. This may also explain why many of the smaller companies, many being unincorporated, show lower capital ratios.

We have to see of course, that as mentioned before many of the exposures to such smaller corporates may fall in the retail portfolio. However, due to an hardened granularity criterion the maximum exposure in such portfolio could be considerably lower in smaller banks, so that even SMEs would be corporates.

Corporate exposures with negative equity

Negative equity firms receive a 300% risk weight: however, negative own funds are not unusual for SMEs, in particular for general partnerships/uncorporated companies where liabilities may not be entirely covered by assets. In fact, in this form of company the line between the assets of the individual and those of the companies may be in the discretion of the entrepreneur and depend on multiple factors such as the fiscal treatment of certain assets or interest deductibility. In certain jurisdictions, private assets are available also for support of the corporate exposure. There might be very good reasons for the entrepreneur not to have very much capital in his company and even to have negative own funds. Overall, the negative own funds does not necessarily mean insolvency.

In addition, firms with negative equity do not have by definition troubles in servicing their debts. In practice they may prove as reliable payers, and this is also true for small private limited companies with negative equity where the managing shareholder vouches for the company.

Finally, the proposed approach clearly gives an important advantage to listed corporates due to the ready availability of data.

Q.8 Do respondents agree that introducing the specialised lending category enhances the risk sensitivity of the standardised approach and its alignment with IRB?

We have strong doubts on the statement of the consultation paper that specialised lending generally exhibits higher risk and losses than other types of corporate lending. Indeed, the proposed risk-weights applicable to specialised lending, with a floor at 120% or 150%, is extremely penalizing and totally disregards the multiple safeguards and covenants associated with these transactions.

The specialised lending (SL) transactions defined in the proposal are based on valuable assets, cash flows, ring-fenced structures. However, the proposed rules do not take into account SL strong inherent mitigants (e.g. securities on valuable asset, on tangible cash flows, ring-fenced structure).

The Committee also refers to the “Empirical evidence [that] shows that specialised lending generally exhibits higher risks and losses than other types of corporate lending”. On the other hand, instead, to illustrate the better recovery rates registered on the SL perimeter, S&P and Moody’s studies on Default and Recovery Rates in Project Finance

have typically provided evidence that recoveries are better in this industry than in the corporate unsecured lending activity.

The application of the proposed RWs (120%, 300%) would lead to dramatic increase in margins, unsustainable for real economy sectors (e.g. transportation; PPP; infrastructure; power; commodities, etc). This would contribute to the expansion of non-regulated financing and shadow banking and to the reliance on volatile capital markets (if and when available). Eventually this may increase distortions between the regulated banking sector and non-regulated shadow banking/investors, posing a real problem of level playing field and a threat to financial stability.

It could force banks to finance projects and assets on a corporate base (unsecured) rather than SL base in order to reduce the costs in terms of capital. This will eventually increase the credit risk and could encourage investing in higher yielding projects which by nature are more risky.

There is a strong need for more granularity for the various forms of SL (Project finance, Commodity Finance, etc.). This could be done through:

- Determining specific risk weights by subcategory, e.g. taking into account structure/collateral specific elements (for example: if more than 100% commodity collateral);
- Recognition of non-financial collateral through the Credit Risk Mitigation framework (e.g.: liquid and exchange-tradable (hence objective valuation) commodities could be recognized in a similar way as gold);
- Define specific lower floors, when structure/collateral is present.

We propose to hold industry surveys/technical meetings with the BIS and banks in order to find more relevant risk drivers for SL.

3. Retail portfolio

Orientation criterion

The paper only refers to exposures to "small business", without giving any more detail. However, since the overall exposure to such companies may reach a threshold of up 1 million €, it can be concluded that a "small business" may reach a certain relevant size. The members of the EACB suggest to include not only small, but also medium-sized businesses in that scope and to set a limit for SMEs like in the EU (<250 employees, ≤50 million € annual turnover and 43 million € total balance sheet).

Granularity

The Basel Committee rightly considers the diversification criterion to be one of the primary justifications for the current preferential treatment. However, enforcing this criterion as a binding quantitative granularity criterion (set at 0,2% of the overall regulatory retail portfolio) is not the right way to pursue the objectives of the proposed revisions to the SA.

However, adopting a 'one-size-fits-all' approach in this area, and setting a very low threshold, is likely to result in unintended negative consequences. Indeed, for institutions with small portfolios the proposed thresholds can be reached very easily. Therefore, small business-retail customers of smaller banks would be strongly discriminated and competition within the banking sector is likely to be distorted via regulation.

Moreover, the interference of both the corporate risk drivers and the strict retail criterion could lead to very important cliff effects: once an exposure to a small company falls out of the retail portfolio with 75% risk weight, it may qualify for a 130% risk weight as a corporate exposure: due to the fact that the leverage of the smallest companies tends to be rather low, such effects would probably be very frequent.

This can entail significant drawbacks: the specific business model of small banks – informally-intensive and traditional lending activity (so called relationship lending) – might be negatively affected by regulation. In particular:

- The too-small-to-succeed problem would be exacerbated due to regulatory-induced incentives to grow in size (while in some cases merger operations are the best way to increase efficiency and strengthen the resilience of very small banks this principle cannot hold true for every case);
- Multiple banking relationships can be one of the banks' reactions. As a result the commitment of the bank towards the SMEs-borrower would be weakened and in turn the pursuing of the typical benefits of the relationship lending would be jeopardized.

Eliminating any national discretion for the granularity criterion is not useful and does not strike the right balance among the objectives of the level playing field, financial stability and bio-diversity of financial and non-financial sectors.

It's imperative for the growth of regional economies to maintain the availability of credit to retail individuals by smaller credit institutions. In some cases, the marketing area of credit institutions is even restricted to one single region. It is important for the soundness of financial institutions to have a granular retail portfolio.

The proposed 0.2% of granularity criteria would impose harsh constraints on credit availability, and raise pressure on supervisors and policy makers to ensure that regional economy is unharmed by imposing relatively too strict thresholds.

We believe that the granularity criterion should be maintained as a qualitative requirement and national discretion should be allowed to detail it. Otherwise, a granularity threshold of at least 2% would be needed.

Alternatively, in light of the above, a proportional approach could be envisaged for credit institutions with a retail portfolio below EUR 500 million (0.2%=1/500) to be subject only to one criteria, i.e. EUR1 million, removing 0.2% granularity criteria.

We agree with the indication of footnote 53 that no circular calculation has to be made and that granularity criterion is to be verified only once.

As for the threshold value of individual exposures, we believe that it should be raised to 1,5 million (this level was determined before 2003) and adjusted to inflation on a regular basis.

Impureness Rate

Furthermore, we believe that a certain "impureness rate" of the retail portfolio should be allowed, which could provide to include smaller exposures to corporates into the retail portfolio (e.g. up to a maximum of 10% of the portfolio). In fact, particularly in the case of very small exposures to corporate entities, the suggested treatment for corporate exposures, which requires a steady evaluation of balance sheets seems disproportionate

Q.9 Can respondents suggest, and provide evidence on, how to increase the risk sensitivity of the regulatory retail exposures treatment, either by differentiating certain product subcategories for which a specific risk weight may be appropriate; or by suggesting simple risk drivers that could be used to assess the risk of all retail exposures?

Where a simplified approach has been developed for smaller and less complex institutions any "cliff effects" should be avoided in order to prevent such simplified solutions from becoming a disproportionate burden for these institutions. This can be the case of the migration of a SME exposure from the regulatory retail portfolio to the corporate portfolio.

In order to prevent a significant cliff effect we believe that the current treatment to non-retail small business exposures should be maintained. In alternative, a 100% risk weight should continue to be applied in the following cases:

- sole proprietorship or self-employed or micro-small business entities that do not meet the criteria to be considered as retail exposures;
- SMEs that do not meet simply the loan size criterion.

The preferential treatment of 75% right weight is fully justified. Therefore we do not see any reason to increase it or use other risk drivers to differentiate the risk of retail exposures which can result in an increasing of the risk weight.

Specific Products deserving lower risk weights

In addition, the Consultative Paper suggests that the respondents provide evidence on specific products that have different risk characteristics, compared to the other retail exposures. About this aspect, we propose a specific supervisory treatment for Salary Secured Loans and Pension Secured Loans. This technical form of consumer credit is supported by a series of guarantees that reduce the credit risk in comparison with other forms of retail loans. Salary Secured Loans and Pension Secured Loans clearly have numerous characteristics that mitigate risk: accordingly, a favourable prudential treatment (risk weight lower than 75%) should be applied.

Furthermore, the "established relationship" might play an important role especially if it is a relationship lending type (e.g. in taking influence on the behaviour of the counterparts in order to prevent and manage their crisis). Therefore, further and deepened analyses

should be carried out in order to ascertain if it can be considered as a risk driver (or in combination with others) to better differentiate the risk of retail exposures and hence to apply a risk weight lower than 75% to exposures whit such characteristics.

On the other hand, we generally do not favour any additional criteria (product related, income, etc.) for the retail portfolio in general. The retail business is a mass business, in which the cost component is playing a central role. Any additional prudential requirements for the standard retail business, e.g. income available to service loan, would blow up the administration considerably,

4. ***Exposures secured by residential real estate***

We do not see any reasons for the modification of the risk-weights for these exposures. In the EU there has been no evidence of risk capture problems with the current SA for credit risk. Were there the need for regulatory action, competent authorities in the EU are already entitled to set higher risk weights based on the loss experience and forward looking market developments of exposures secured by immovable property. Thus, in particular for the EU, these changes are unnecessary.

In general, the proposals for residential real estate do not seem relevant for all markets (for instance comparing the EU and US, but also within the EU).

The proposed one-size-fits-all approach, while trying to result in increased sensitivity, reveals certain limits that may lead to unintended consequences especially for residential real estate markets characterized strongly by domestic specificities in particular in the areas of social welfare system; legal system regarding mortgages; country specific mitigating factors (guarantee systems, mandatory building of savings). In particular, the approach does not take into consideration any insurances that ensure the repayment of the loan, e.g. in case of sickness or death of the lender. In some countries there are even state programs that provide insurance against unemployment.

The proposed revision would also entail enormous impacts in applying the new risk weights to existing lending, for a number of reasons:

- Instant re-pricing is legally not possible; this would have a direct impact on issuing capital and/or reducing assets (e.g. also by means of securitisation);
- It would have severe and punitive effects on high quality portfolio's with almost zero losses (long term based);
- Key data under the new proposal such as DSC would not have been captured;
- Retrospective application would create undue burden on all banks, and in particular smaller credit institutions whose assets are generally tilted toward residential mortgage. Overall, the new proposals are too complex to be suitable as a revised standardised method for smaller simpler banks. Credit institutions already face a massive burden at the point of transition; they do not have the back debt service charge data to reclassify the back book of loans. A prudent way forward would at

least allow banks to apply the new rules to new loans from an agreed cut off date and leave the back book at 35%.

The proposed revision also poses a question of level playing field (e.g. *vis à vis* insurance companies) and could trigger short termism in customers' relationships, creating expectation and incentive to renegotiate loans with other institutions in order to enjoy better conditions due to different risk allocation (with the underlying risk remaining the same).

Q.10 Do respondents agree that LTV and/or DSC ratios (as defined in Annex 1 paragraphs 40 and 41) have sufficient predictive power of loan default and/or loss incurred for exposures secured on residential real estate?

Q11. Do respondents have views about the measurement of the LTV and DSC ratios? (In particular, as regards keeping the value of the property constant as measured at origination in the calculation of the LTV ratio; and not updating the DSC ratio over time.)

Q12. Do respondents have views on whether the use of a fixed threshold for the DSC ratio is an appropriate way for differentiating risks and ensuring comparability across jurisdictions? If not, what reasonably simple alternatives or modifications would respondents propose while maintaining consistent outcomes?

Q.13 Do respondents propose any alternative/additional risk drivers for the Committee's consideration in order to improve the risk sensitivity in this approach without unduly increasing complexity?

The proposed risk drivers have only limited predictive power for probability of default. For instance payment in arrears and utilization of consumer credit have a better predictive power. It has to be noted that there is no fixed (linear) relation between LTV and loss given default and the DSC at origination provides limited information regarding credit losses. Moreover, retaining valuation and DSC as at origination is flawed as it discriminates against lenders who retain their customers and also their customers whose risk profile diminishes over time.

The features of residential loans show an important degree of differentiation across jurisdictions. A single treatment of real estate exposures, not recognising local legal frameworks, may result into a misleading picture of the actual risk profile. The use of local sensibility should be a necessary element of the picture.

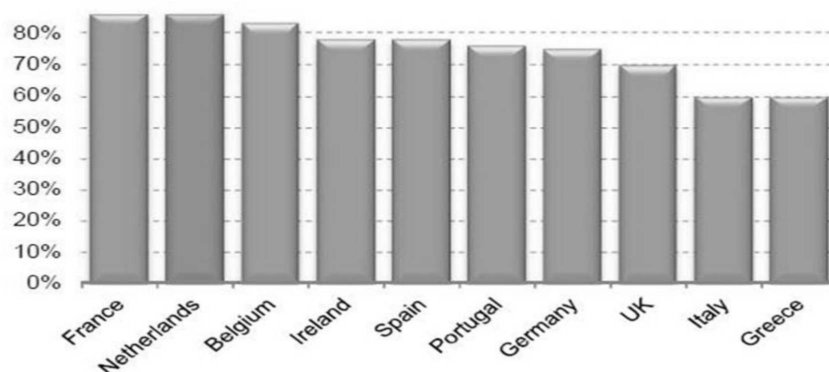
Use of LTV

In general, if on portfolio level we can observe lower losses in the lower LTV buckets and higher losses within the higher LTV buckets, ceteris paribus, within a single jurisdiction, when comparing similar LTV buckets between jurisdictions the picture is blurred. On average an LTV of 70% in country X does not represent a comparable risk profile compared to the same LTV in country Y. This implies that setting comparable risk weights

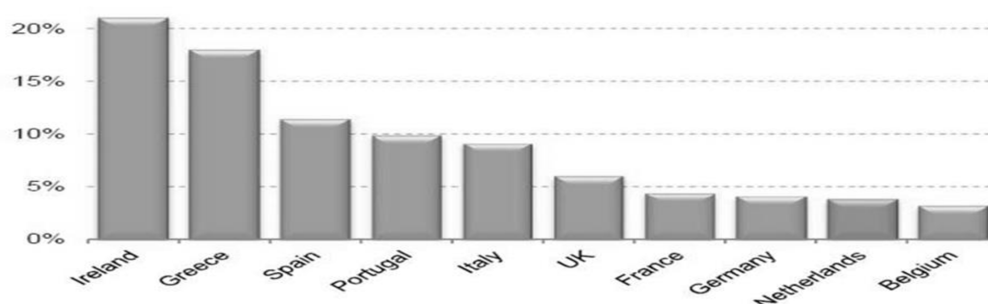
globally would create a false comfort: risk weights levels will be comparable while the underlying risk is different. There are several explanations for these differences in risks between jurisdictions, such as differences in social welfare systems, tax regimes, consumer protection laws, government guarantee schemes etc. This guarantee scheme lowers the threshold for individuals to purchase a house, by lowering the risks for the banks in some countries, and in turn, lower interest rates. We urge the TFSA to take into account the risk mitigating effects these kinds of guarantees bring, resulting in lower risk weights.

The Probability of Default (PD) is an important driver in the IRB framework. As it can be seen in the graphs here below, the LTV ratio itself has a limited predictive power for the PD. The average LTV on mortgages per country, is coupled with a very different expected default rates per country. Thus, the conclusion is twofold:

- First of all LTV is not a good predictor for defaults when comparing default ratings across countries;
- Secondly, were the LTV to be maintained as a risk driver, national calibration is key.



Graph. 1: LTV at origination of a typical securitised portfolio of residential real estate



Graph. 2: Expected default rates for portfolios of residential real estate

Update of LTV

The use of LTV at origination (only) is not in line with good risk management, and their use to label a loan at origination as high risk for its lifetime is counter-intuitive, as it ignores the well established phenomenon of "seasoning".

Moreover, the use of LTV at origination (only) may have a multitude of negative, counterproductive effects:

a. It discourages longer-term lending relationships and rather creates incentives for lenders to switch to other banks or to cancel and originate a new loan with the current bank in order to draw advantage from a better LTV or DSC after some years, when the outstanding debt is reduced due to repayments, when the income has increased due to indexation and when the value of the property has increased.
b. This would also imply that lenders move away from long term financing at fixed rates to short-term contracts (where there is no fixing of an interest rate.

However, the update of such information should be determined without creating undue administrative burden and bearing in mind the relevant costs that such kind of data collection would entail. On the other hand, with regard to the DSC, it would be very difficult to know on an ongoing basis, apart from origination, the service payments amount due to financial obligations granted by other banks.

The DSC

The DSC is only a very rough indicator. It has to be seen different in the case of a person with a high income (and patrimony) compared to a person with a low income. A 35% factor has not the same relevance for a single person compared to a person, who has to feed an entire family. Moreover, ensuring consistent DSC calculations is challenging due, for instance, to the variety of sources of income of borrowers. Working out net income at origination presents problems. An example is working out what the net income after tax would have been – given that taxation changes from one year to the next. Moreover, the consultation is not clear on whether lenders take the income at origination and apply the current taxation level; all it says is that "total income must be net of taxes and prudently calculated." Furthermore, tax is hardly a simple calculation just based on income. Given these complexities, should we expect the regulator to be more prescriptive on this? However, an actual DSC is also a data issue, to be seen in connection with its frequency of update.

A more powerful predictor to be considered could be for instance the past credit history of the borrower. As possible alternatives a differentiation of the housing market, e.g. stable/less stable/more stable (based on better loss predictive information) could be considered. In the end, a 35% risk weighted could even be better than the unbalanced, and limited risk drivers proposed as factors for probability of default. This would have the advantage to avoid a too complex revised standardised method for smaller and simpler lenders.

The current proposals also disregard additional collateral/guarantees received for exposures secured by real estate. In fact, banks may grant higher LTV loans given other mitigating factors (mutual insurance, parent guarantees, mandatory building of savings, sovereign guarantees, financial collateral). If a risk sensitive approach is to be designed, one should take into account also the sustainability of house prices, with sustainable increases to be reflected in the risk weight determination.

With reference to destination of use of the considered real estate , the mortgage loans to buyers of "first houses" (i.e. main residence) show an expected loss lower than other kind of exposures. As a matter of fact, these specific householders have all interest to pay their instalments to avoid to lose their "own" (and often "only") house, without considering the value of property compared to the mortgage loan.

Finally, the requirement for qualification as residential real estate exposures to be a "finished" property (i.e. concluded) cannot apply to self-builds. Self built residential properties are instead even specifically regulated in certain legislations (e.g. triggering tranche payment only on completion of a specific building phase) and should be adequately addressed.

Also the impact and the relevance of interest rates in the calibration of the ratios should not be overlooked. For instance, fixed and variable interest rates would impact differently the determination of DSC, this should be taken into account when calibrating the ratio. Moreover, a cap in the property value could be considered in the LTV calculation for variable rate loans to reflect the mark to market base of the corresponding ALM position.

An equivalent legal framework: the French mortgage guarantee system

The French residential real estate is intrinsically a low-risk market.

Different insurance policies and guarantees can be used, as for example the "caution" or surety companies' guaranty. This system is very closed to the "mortgage insurance system" and extremely safe, as recognised also within the analysis 11/211 of the IMF 2011, the EBA Fourth report on the consistency of RWAs in the residential mortgage portfolio (June 2014) and the Annual survey of residential financing published by ACPR. Also the Joint Forum clearly acknowledged the soundness of the French guaranteed loan system in its August 2013 document on mortgage insurance.

Thus, guaranteed loans and mortgage loans are totally equivalent and should all be included within the "retail mortgage" portfolio. This is a matter of level playing field and crucial for the real estate market. However, the proposal of the Committee is overly conservative, as it applies risk weight above 75% to all retail exposures irrespective of the existence of a guarantee, while such guarantees should be reflected in the risk weight assigned.

The proposed RWs would penalize the development of the financing system in France, which has already shown its resilience in terms of risk follow up and is fully supported by the French regulator and the French government. This is in fact a key economic tool,

especially when banks finance small structures dedicated to real estate development projects.

Overall, and as illustrated in this example, the standardised approach applicable to residential real estate should envisage a bucketing allowing exposures to receive a RWA below 35% to a greater extent than proposed (on the basis of LTV below 80%).

5. ***Exposures secured by commercial real estate***

Q.14 Which of the two options above is viewed as the most suitable for determining the risk-weight treatment for exposures secured on commercial real estate?

Q15. What other options might prudently increase the risk sensitivity of the commercial real estate treatment without unduly increasing complexity?

We believe that the proposals for commercial RE exposures are strongly influenced by bad experiences recorded in certain countries in recent years, although other jurisdictions have not undergone the same difficulties. Thus the approaches envisaged do not reflect adequately market characteristics and are overall too conservative with regard to loss rates experienced with commercial and real estate collaterals.

In general, we appreciate the flexibility provided under the proposed Option A, although some of the criteria described in footnote 59 to allow a preferential treatment may still be too strict.

For instance, Option A requires that "the risk of loan repayment must not be materially dependent upon the performance of, or income generated by, the property securing the mortgage, but rather on the underlying capacity of the borrower to repay the debt from other sources"

We believe that there is a need for an alternative/possibility to derogate from such rule, where a well-developed and long-established commercial immovable property market is present in the affected territory, and with loss rates which do not exceed certain limits (e.g. see Art. 126(3) CRR[2]). Thus, the low loss rates shall be envisaged as an alternative requirement instead of a cumulative one.

Moreover, the indirectly imposed finished property requirement may be counterproductive as real estate being a non-essential business asset often is vacant while serving best for credit risk management purposes; the requirement may also cause problems with forest or agricultural land.

With regard to Option B, we see that it is overall not sufficiently flexible. Moreover, it is unclear why the RW for commercial real estate could lead to higher RW than for similar

[2] *"a) losses stemming from lending collateralised by commercial immovable property up to 50% of the market value or 60% of the mortgage lending value, unless otherwise determined […] do not exceed 0.3% of the outstanding loans collateralised by commercial immovable property;*
b) overall losses stemming from lending collateralised by commercial immovable property do not exceed 0.5% of the outstanding loans collateralised by commercial immovable property."

exposures in different categories (e.g. when the exposure could otherwise be treated as Retail exposure or as a corporate exposure with low leverage).

This seems to be not in line with para. 63 ("No transaction in which CRM techniques are used shall receive a higher capital requirement than an otherwise identical transaction where such techniques are not used").

6. ***Other elements of the consultation***

Q.16 Do respondents agree that a risk weight add-on should be applied to only retail exposures and exposures secured by residential real estate? What are other options for addressing this risk in a simple manner?

Q.17 Do respondents consider the categories for which a CCF is applied under the standardised approach to be adequately defined?

Q18. Do respondents agree that instruments allocated to each of the CCF categories share a similar probability of being drawn and that the probabilities implied by the CCFs are accurate? Please provide empirical support for your response.

Risk weights on commitments that are unconditionally cancellable at any time without prior notice should continue to be treated as 0%, considering the consistency with terms & conditions in the facility agreement.

We disagree with the choice of not marking a difference between commitments with different maturities (currently with 20% and 50% CCF, depending on the maturity, but now proposed to receive a uniform CCF of 75%) as this approach will not be risk sensitive and does not add to the comparability of RWAs with IRB banks (as the one year maturity floor may be lifted for some trade products). It will also provide wrong incentives for banks to issue commitments for longer periods, and it is not consistent with banks' internal historical drawdown rates.

The aim of the review would be to align the credit risk SA and FIRB, but no reason is given as to why the 75% CCF under FIRB is more appropriate that the existing credit risk SA CCFs of 20% and 50%. We would be keen to understand more the rationale for this, e.g. to see any quantitative analysis justifying the higher CCFs.

Specifically for trade finance, we suggest the Committee to provide more guidance on the CCFs for guarantees along the lines proposed by the ICC. We are of the opinion that a distinction should be made between undrawn lines and other contingent exposures and to address CCFs at product level instead of facility level.

Q.19 What are respondents' views on the alternative treatments currently envisaged for past-due loans?

In general, the classification of past due exposures should remain as simple as possible to allow the use of automatic mechanisms.

Q.20 Do respondents agree with the proposed treatment for MDBs?

We believe it is important that government backed MDBs maintain a risk weight of 0%.

Q.21 What exposures would be classified under "Other assets"? Is a 100% risk weight appropriate? (Please provide evidence where possible).

According to the proposal, the 100% risk weight would be applied to all "other assets". However, while cash as eligible financial collateral is addressed and given a 0% haircut, cash in hand and equivalent cash items not falling in the financial collateral class do not have specific treatment. We believe that these assets should not fall among this residual category, and should receive a 0% risk weight. Also gold bullion should be treated as cash and receive a 0% risk weight. Cash items in the process of collection can instead receive a 20% weighting.

The approach should allow banks to perform the most pragmatic and simple determination of "other assets". In practice, such exposure often stem from tax refund claims or commission receivables or gold, so that a rate lower than 100% would be reasonable.

In addition, the previously practiced weighting at 100% of tangible assets (such as real estate, office furniture and equipment and machinery) is questionable. It seems consistent to include under the SA only those items which imply a counterparty risk.

Q.22 What are respondents' views on the above alternative ways to define eligible financial collateral?

Selecting only a few criteria creates the risk of lack of accuracy and high volatility. There should only be a definition of simple, homogeneous rules to be applied, to maintain a simple method.

Q.23 What are respondents' views on the recalibrated supervisory haircuts shown in Table 4? What are respondents' views on how to eliminate references to ratings from the

supervisory haircuts table? What could be the implications of eliminating references to external ratings?

The haircuts for High Quality Securitizations (HQS) are too high. HQS should receive a preferential treatment, this could be the case for instance for top-rated ABS, such as Auto ABS. In this respect, work on HQS is being carried out by the Committee and IOSCO.

Q.24 What are respondents' views on the proposed corporate guarantor eligibility criteria?

A crucial element to attain a fair reflection of the actual risk is credit risk mitigation.

The SA framework looks at borrowers' characteristics, while many banks' business models are based on a strong structuring (collateral, control, etc.), which could even be the core skill of the institution (credit risk assessment). Not including non-financial risk mitigation is therefore bound to lead to wrong incentives as risk sensitivity would be lost, especially within high-quality portfolios such as mortgages, commodity finance, etc.

We therefore recommend:

- Specific risk weights taking into account structure/collateral specific elements (for example: if more than 100% commodity collateral)
- Recognition of non-financial collateral through the Credit Risk Mitigation framework. E.g. In our opinion commodities with deep markets and transparent valuation such as crude oil and wheat should be recognized in a similar way as gold.
- Specific lower floors, when structure/collateral is present.

This would also contribute to a better comparability of RWAs among SA banks and between SA banks and AIRB banks, without the burden for SA banks to develop costly internal models.

Concerning the Committee's willingness to simplify the treatment of credit derivatives, we would like to highlight that standard contracts for North American CDS do not specify restructuring as a credit event. The restructuring requirement mentioned in section 3.4 of the consultative document would strongly disincentive banks to hedge their exposures on US names or force them to execute nonstandard CDS (i.e. including the restructuring clause) that will be both less liquid and non-eligible to clearing houses.

While the mere fact that these contracts could not be settled through a clearing house seems contradictory to the general regulatory imprint, it can be underlined that according to market participants, no restructuring credit event occurred in the US since 2003, this kind of credit event being generally operated under chapter 11, bankruptcy filing.